

Conversations with Commerce Trust

Forces Shaping Equity and Fixed Income Markets

Recorded October 20, 2026

David Hagee, Chief Investment Officer: Hello, and welcome to Conversations with Commerce Trust, our show about the markets, investment themes, and economic insights that matter to you. I'm your host, David Hagee, Chief Investment Officer with Commerce Trust.

Today, we're discussing the equity and fixed income market dynamics with Brent Schowe, our Director of Fixed Income and Manager Research, and Don McArthur, our Director of Equity Research. Welcome back to the podcast, guys!

Brent Schowe: Thanks, David.

Don McArthur: Thanks for having us.

David Hagee: Thanks for joining the podcast today, I'm excited to talk about this. This has been a wild year for us. We've gone through, sort of, three major phases inside each quarter. Across each quarter, there's been a disruption.

First quarter, certainly, we had the Iran War. Inside the second quarter, you had a major lift off AI (artificial intelligence) earnings and spending. And then inside the third quarter, you had this disruption with interest rates moving up, fairly dramatically here.

So, across that all looking at the returns, you're looking at the S&P 500 (Index) through Monday (October 19th), being up about 13% on the year, and then if we look on the fixed income side the aggregate bond index (S&P U.S. Aggregate Bond Index), so sort of the S&P 500, or the proxy for the broad bond market down 1.63%. So, I thought it would be helpful to start to unpack exactly what's going on. Maybe we could start on the equity side with Don.

Don, you know as we're looking at this, earnings certainly drive the market. You look kind of at that combination of earnings and valuation, what sort of highlights have you seen so far inside the third quarter earnings, which we're in the midst of today, and more broadly across 2026?

Don McArthur: Well, third quarter earnings are expected to be very strong. Looking for revenue up 12%, EPS (earnings per share) up 27%, and that's increased by almost 2% since the quarter started in July. And that's very different. Usually, earnings revisions for the third quarter are downward by about 3% to 4%, so coming in much better than expected. And as you can imagine, that's driven by AI. And that's also a continuation of what we've seen all year. Earnings revisions are up 21% since we started the year. So, coming in much better than originally anticipated.

David Hagee: I think that this broader theme that we've been talking about of this AI build-out lifting all boats, this rising tide lifting all boats here, yeah, you're seeing that certainly in earnings, that it's a rarity that you see earnings being revised upward over the course of the year, as opposed to, sort of pushing downward, which is the typical course for that.



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As we looked through AI, you know, what stands out? I mean, originally this story was around the MAG 7 (Magnificent Seven), the cloud providers and the chip providers. What stands out to you in terms of AI's broader impact on earnings?

Don McArthur: I think the question is, is there anything else but AI in this market right now? So, we look at the infrastructure of the semiconductors, all the hardware, the servers, the networking that connects it, the hyperscalers, the Googles and Microsofts that host it, etcetera. And if you look at that, in 2026, over half of the earnings growth is driven by AI.

So in 2026, AI names net income are going to be up 67% year-over-year. Non-AI are up 23%, so still good. So the AI names contribute to 56% of the earnings growth. And that trend continues into 2027.

David Hagee: So, you know, AI has certainly been the catalyst inside the U.S. economy as well as inside the equity markets here. You know, maybe let's talk about a couple other sectors. I mentioned maybe the first distortion inside 2026 was the Iran conflict, certainly its energy impact. And I think that's a great transition question at some point, to the fixed income conversation. But, you know, let's talk a little bit about what other sectors have done well inside of 2026.

Don McArthur: So, in 2026, five sectors are actually up double digits, so strong performance. Within earnings growth, energy is one of the top performers, which, earnings are expected to double over last year with higher commodity prices. And the natural concern would be, well what about the consumer?

And if you recall as we came into 2026, we had a large tax benefit from the bill that was passed in 2025. So, consumers came into the year getting a large tax refund, and then lower withholdings. And these were things like no taxes on tips, no taxes on overtime, SALT (state and local tax) deduction was different, standard deduction was different.

So the consumer had a big tailwind. So maybe they put all that benefit into their gas tanks, but that still allowed them to spend throughout the year in 2026 so far.

David Hagee: Yeah, it's a great point on the consumer. Certainly, lower income brackets have a disproportionate amount of energy impact in their spend but, you know, there has been a broader lift from stimulus off the One Big Beautiful Bill Act (OBBBA) that we've seen here. And then in the back half of the year, you get full depreciation, so corporations are getting a benefit from being able to write off more and more.

And then, you know, kind of how this impacts the markets, we started the year at what I would call, not a rich valuation, but a slightly expensive valuation for the broad U.S. market. As we're looking at valuations of equities right now, what are your thoughts around that?



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Don McArthur: So in valuations, we started off the year, if you look at forward 12-month earnings expectations, we're at a price-to-earnings ratio of 22 times. However, earnings have been revised higher for the next 12 months by 29%. So, even though the S&P 500 is up 12%, 13% year-to-date, the valuation of the S&P 500 is actually lower at 18, 19 times, so valuations have come down by about 13% year-to-date. And the expectation is earnings growth likely continues into 2027.

David Hagee: Yeah, so looking forward into 2027, it would appear that we have a couple of headwinds. Inflation has remained persistently high. As we talked about earlier, the consumer is a significant part of the earnings engine here. And so, you know, inflation has remained high. You have growth that's maybe moderating but still growing at around that 2% clip. Prospects for Q4 (fourth quarter) and 2027, you know, are we still on this trajectory to have this sort of standout growth years?

Don McArthur: Yeah, we actually are. In 2027, the consumer outlook is a lot more difficult. We don't have the consumer tax rates. We're going to have higher gasoline prices coming through. We're going to have higher fuel costs from diesel coming through, and raising expenses on a lot of other areas. Corporations won't have the benefit from tariff refunds that they received in 2026, and as you mentioned, they'll be lapping that benefit from depreciation. So it looks a little bit more difficult, but we also have AI. If we look at AI names next year, they'll likely generate income up 25% versus non-AI up 4%, and that will likely contribute over 75% of earnings growth in 2027.

So, we still have a healthy outlook. Right now, consensus is looking for revenue growth of 9%, and EPS growth in the high teens for 2027.

David Hagee: Yeah, so that's good news that we continue to see earnings growing at a nice clip here. Maybe not the pace that we were growing across 2026, certainly, but who knows? So, you know, that gives you some ballast for continuing to own a stock portfolio out there.

You know, as we're looking forward into the interest rate markets, Brent, I've been struck by the move that we've seen inside the third quarter. If we are looking at the start of the year, the U.S. 10-year, or at least the low for the U.S. 10-year Treasury yield was 3.95%. Today, as we sit, we're about 5.10% on a 10-year. Maybe we could unpack a little bit of what's going on inside the fixed income markets. Even though it seems relatively small, I call it a 1.15% increase in the 10-year. That's a seismic move inside the fixed income markets. Brent, what are your thoughts here?

Brent Schowe: Yeah, 115 basis points, it doesn't probably seem like much to the average person, but in bond land, that's a big move. And so, I think, you know, you mentioned in February we hit a low below 4%. It almost seems like a lot longer than, you know, 8 months ago that we had below 4% 10-year Treasury yields.



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But, you know what we've had since then, right, is the Iran War, and we've had the inflation associated with that. But I think that the bigger story, and maybe it's a little unrecognized, is all the growth that Don talks about. The AI build-out, the wealth effect, boosting consumer spending.

And really, the biggest move in rates has been from the outlook for growth. I think heading into this year, most economists would have guessed that, especially with the, with the Iran War, giving us the headwind, we would have lower growth in 2026 than we did in 2025, but it looks like we are going to exceed that 2.1% growth rate. So, interest rates are following that path, and of course they will follow inflation higher, but they're also following real growth higher, so we're getting kind of a double whammy since the Iran War, and with all the earnings that are coming through in the big tech names, and so it just seems like there was no stopping it in September, right? We were hitting all-time highs in the equity market, and the Treasury market was just moving higher as well. Right now like you said, we're at a 5.10% yield. That seems to be something like fair value, we would say at this point.

But again, you know, if growth goes higher and inflation surprises on the upside, you can see those rates continue to climb.

David Hagee: Yeah, you know, as we started the year off, in 2025, the Fed (Federal Reserve) had just finished up doing some rate cuts over the course of the year. You have this Iran conflict mushroom up inside the first quarter there, and now we're on a different path. As we're looking at Fed funds rate today, you know, what are we anticipating? What have we seen? Why has the Fed pivoted here?

Brent Schowe: Right. If you recall, back in, at the end of 2025, they gave us three rate cuts. We had a big growth scare, a job scare, we had some negative job prints back then, we had all the immigration effects and the DOGE (Department of Government Efficiency) effects going on, and so the Fed gave us three rate cuts, so 75 basis points.

It seems like now they want to take that back, right? So, they already gave us one rate hike, back in mid-September, and now it looks like they're going to give us another one, not at their next meeting, that's coming on October 28th. That one's kind of priced out, but it's, you know, the bond market's pricing in a pretty high likelihood that they're going to give us another 25 basis points of a hike come December.

And then, we're going to get one more probably in the spring. So, there's your three hikes coming back, unwinding the accommodation they gave us. So, I think, you know, the inflation has them concerned. It's very sticky. The PCE (Personal Consumption Expenditures Price Index), that core PCE measure they like, is at 3%. They want it closer to 2%. And so they're going to try to put their foot on the brake of the economy, but whether the AI boom is going to listen to them, that's yet to be seen, probably.



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David Hagee: So, as we sort of talk about the more broad fixed income markets, if we dive a little bit deeper into credit, into specifically corporate credit, you know, I've been struck that broadly, investment-grade credit has remained relatively unstressed, but are we seeing signs of stress anywhere inside the corporate market?

Brent Schowe: Yeah, you have to squint pretty hard to find it. Places like private credit, we've seen a few blow-ups there in certain, you know, software firms, you know, non-publicly traded things that most people don't invest in.

But now you're seeing it a little bit in the high-yield market. Investment-grade spreads have been hanging in there pretty well, right? We're about right in the middle of our average that we've been year-to-date, which has been a very low level relative to long-term history.

But now you have corporates now, just checked this morning, their spreads are at 329 basis points, right? So, a little over 3% above Treasuries, which in the big scheme of things isn't that much. But that's very close to the high we had for the year already, right? We're within a handful of basis points of that. So, the high-yield market's sniffing out a little something, and really, it's in the weakest borrowers. You have this lowest rung of high-yield borrower, known as the CCC borrower, basically that last rung before they hit default, and those spreads have really gapped out relative to Treasuries.

David Hagee: So, Brent, I asked Don around this. As we look forward into the rest of the fourth quarter here and into 2027, what are you anticipating for rates, both on the short end and the long end?

Brent Schowe: Yeah, as we said, you know, the Fed's at 4% in the very short end, and that's the rate that they control the easiest, right? That's one they can move around. And so, you know, that's going to likely go to 4.5% by, you know, spring of next year, and then it's kind of a wait and see. Where does growth end up? Where does inflation go? So, if you got that as your low-end anchor, that's 4.5%.

You know, the two-year will follow that pretty closely, so the two-year really follows Fed policy, because, of course, it's as close to the overnight rate as anything else. And so, it's at four and three quarters now, so if you have a short end at four and a half it's telling the Fed, you might not want to go too much further, because then you risk that dreaded yield curve inversion, right? If the Fed goes to four and three quarters and five, in the two-year it's below five, then you start getting a whiff of that recession call that we had a couple years ago when the Fed last inverted the curve. So, I think, you know, you're probably in this trading range.

The 10-year and 30-year, they're going to follow inflation a little bit more tightly, and then they're, of course, going to follow fiscal policy, which isn't great. But again, if you look at nominal GDP (gross



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domestic product), we're at 6.3%. I looked this morning. If you go way back in history, it's about a half a percent difference between nominal GDP and the 10-year Treasury, and that's a half a percent lower. So the 10-year Treasury, over long periods of time, should be at about 5.8%, right? And so I think that would be the top end of the range that you would consider for the 10-year Treasury.

Now, if nominal GDP slows, which it might, and if inflation rolls over, which it might, then that 5.8% gets lower and lower. So again, I said earlier, I think, you know, this is a kind of a fair value market for fixed income. And you know, getting yields in mid-5s for Treasuries and in the mid-6s for corporates is not a bad return, especially, you know, compared to what we had in years past.

David Hagee: Yeah, I think that's a great translation. As we look today, Don worked us through this, that, you know, earnings appear to be both legitimate and continuing to grow at a nice clip here, and we have very high yields today, both in the long end and the short end of the curve.

So as you look at portfolios, I think this offers an opportunity where, certainly inside the fixed income markets, that being said the gap between, you know, what we expect, equities to do versus what the yields on a fixed income portfolio offer an opportunity for us to be able to evaluate asset allocation for our clients, and to be able to make sure that we have the proper amount of risk inside the portfolio, and you know, quite frankly we're generating a little bit more return off of our fixed income assets today than we were at the start of the year.

Well here's my favorite part of the pod, getting to a fun stat out here. I'll lead it off. My stat is \$510 billion. That's the capex (capital expenditures), or the spend, for the four major hyperscalers, Amazon, Google, Microsoft, and Meta.

They will spend \$510 billion in capex this year alone. That's more than the entire GDP of Ireland or Belgium, okay? And, that would roughly equate to cutting every U.S. household a check of \$5,500, so just tells you how big this build-out has been, how much energy is behind it, and how much financial firepower they've brought to bear in this space.

Don?

Don McArthur: \$13.5 billion, David, that's my number. That's what consumers plan to spend this Halloween, up from \$13.1 billion the prior year, which tells you that all is well in consumer land.

Brent Schowe: I've got 1.47%. Alright, that's an interest rate, and that is what the weighted average interest rate of all Treasury bonds outstanding was just 5 years ago. So, we were at under 1.5%. Today, that is at 3.52%. So, the stack of debt at the Treasury has increased by 200 basis points, and it's continuing to grow.



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David Hagee: Well it certainly bleeds into the interest costs and that continued deficit spending that we would anticipate, from the federal government moving forward.

Thanks for the interesting discussion today, gentlemen. For more on this topic, please visit www.commercetrustcompany.com for our Outlook, as well as our Look at the Markets. If you've enjoyed what you've heard today, you can subscribe to our show on Apple Podcasts, Spotify, Amazon Music, or wherever you get your podcasts from.

Thank you for joining us on Conversations with Commerce Trust. I'm David Hagee. We'll talk again soon.

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