

Commerce Trust Market Brief with Scott Colbert

A Shifting Inflation Picture

Recorded October 6, 2026

Scott Colbert: Good morning. It's Tuesday, October 6th, and the markets have just opened. Believe it or not, the S&P 500 (index) has reached another record high, up a bit over 14.5% now year-to-date. But underneath the umbrella of the S&P 500, we've seen a re-jostling for returns. It had been that the average and smaller stocks had been doing better than the S&P 500, but we've seen a recent narrowing in the breadth of the markets, as those AI (artificial intelligence) and tech driven stocks have continued to surge ahead.

Note now that the average stocks return (as measured by the S&P 500 Equal Weight Index) is a little bit less than the S&P 500's. The midcap (capitalization) stocks (as measured by the S&P 400 Midcap Index) now have fallen just a bit behind the S&P 500. And while the small cap stocks (as measured by the Russell 2000 Index) are still winning, they were winning by quite a bit earlier in the year.

This trend is also followed along in the international markets now. The largest cap developed markets (as measured by the MSCI EAFE Index) now show a positive return of 9.47%, but they were closer to the S&P 500 earlier in the year. They've been dragged down recently by those higher interest rates overseas and, of course, the rather persistent higher energy prices and especially natural gas prices.

And the big winners have still been the emerging markets (as measured by the MSCI Emerging Market Index), with South Korea and Taiwan pulling those markets ahead. Perhaps the biggest surprise this year, of course, are the continuing negative returns in the bond market (as measured by the Bloomberg Aggregate Index and Bloomberg Municipal Index) as interest rates have surged because of the higher gas prices, because of higher inflation expectations, and no doubt because of the higher (federal) deficits that we're running.

We've also had some modest revisions to GDP (gross domestic product). But note that real GDP, after subtracting out inflation, is exactly the average rate of growth that we've had since the turn of the century, and that nominal GDP is actually a bit better. This higher level of nominal growth provides quite a bit of resilience, and it's one of the reasons we have quite a low probability of a recession within the next 12 months.

That doesn't mean the economy won't eventually slow. We know that the higher energy prices are likely to bite. This year, the average price of a barrel of oil in this country has been \$84 a barrel, compared to \$65 last year. And typically, on a relative basis, this ought to cool economic activity by about three tenths of a percent. And more troubling, down the road of course, are the higher interest rates that we're confronting today. It generally takes 12 to 18 months for a higher interest



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rate environment to slow economic activity, but note the large jump in yields so far this year, over 100 basis points across the curve, a little bit more in the short end than the long end.

And since we last met, we've had a new employment report. The employment report typically impacts the markets the most. This recent employment report showed very little job growth in August, and it pulled average job growth this year down from about 80,000 jobs per month down to 68,000 jobs per month created. This reduction in employment also pushed up the unemployment rate ever so slightly, from 4.1% to 4.2%.

There's a little bit of good news in the sense that the weaker employment report pushed back the market's expectations for an interest rate hiking policy from the Federal Reserve. Before the employment report the markets were about 70 to 80% certain that the Federal Reserve would hike rates this October. In other words, the weaker employment report has likely probably taken out some of the inflation sting that the Federal Reserve is going to have to confront in the future.

And we can already see a modest improvement in our inflation trend. If we go back a year and take the average of the core PCE (Personal Consumption Expenditures Index) and the core CPI (Consumer Price Index), the statistics that the Federal Reserve most likes to look at when it wants to measure inflation. The average inflation rate was 2.98%. Three months ago, it was 3.02% but now, with energy prices having peaked several months ago, we can see the core inflation is down to 2.7%. Of course, this still isn't to the 2% measure that the Federal Reserve wants, but it's an improvement in trend and it's the trend inflationary direction that Chairman Warsh is focused on.

While the S&P 500 is at record high price, you might wonder, aren't stocks then also at record high valuations? The nice news here is that earnings have improved more than the price of stocks. So in other words the price-to-earnings (P/E) have been coming down, and you can almost see this in tandem with the increase in interest rates. In other words, the stock market has been de-risking a little bit this year, discounting some of that higher inflation and higher interest rate environment as its price-to-earnings rate has cooled.

So, over the last three weeks we've seen what? A record high S&P 500, a little bit of narrowing in the stock market, a continued push up in interest rates, but with the cooler employment report and some improvement in inflation, the expectation is the Federal Reserve probably is not going to have to tap on the brake quite as aggressively as the market thought just three weeks ago.



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That's, of course, a lot of information to digest and we'll be back in several weeks to talk about how all the economic news are impacting the financial markets.

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