

INVESTMENT VIEWS

SEPTEMBER 30, 2026

BOND YIELDS BREAKING OUT

It has been a repeated theme in this newsletter to observe the direction of bond yields since the yield says much about economic and financial conditions. Notably, the yield on the benchmark 10-year Treasury closed the month at 5.3%, a level not seen since 2007.

So far, the equity markets have handled the rise well, leaving many experts debating why. Some claim that it is due to inflation, while others point to the fiscal deficit. We believe that a likely reason could be that the market sees a higher nominal GDP ahead and is adjusting for it by demanding a higher real yield.

If inflation expectations were indeed the cause then it would show up in the TIPS breakeven rate, but this is well anchored at around 2.3%. The fiscal deficit argument does not really hold up either as a good portion would also show up in breakeven rate, as well as other more nuanced models.

Instead, we are seeing the bond market demanding a higher real yield, lending itself to the higher nominal GDP narrative as domestic policy has firmly shifted to the reindustrialization of the U.S., which is supportive of GDP and equities.

For sure, higher rates will challenge stock valuations, mortgage rates and corporate financing, but we may just be getting back to the normal levels seen before the Great Financial Crisis of 2008. For us, it is not necessarily the level, but the manner in which interest rates move.

POLICY MISTAKE AT THE FED?

The Federal Reserve hiked rates for the first time since cutting rates about a year ago. The decision was unanimous, with all FOMC members voting to raise rates to fight inflation. However, most evidence points to the oil supply shock as the cause for recent “hot” inflation numbers, not excessive aggregate demand. Though the hike was only 25 basis points, the larger worry is that the FOMC may continue to raise rates, which could end up hurting certain sectors of the economy. We note that changes in the Fed Funds rate have a lag of at least 12 months or longer to show up in the economy so by the time the effects start to show up the oil supply shock may have already dissipated.

It is also possible that the Federal Reserve is attempting to demonstrate that it is credible and independent, defying the current Administration repeated demands for interest rate cuts over the past year. While a single hike is unlikely to have any major effects in the US economy, further FOMC hikes into a supply shock could do harm while causing little good.

MICRON AND THE MEMORY WALL



Micron just reported another record quarter and they expect this to continue through the next year as well. What is benefitting Micron is the fact that the types of memory chips they produce are the key bottleneck to computing power needed by large language models and the exponentially growing market for Agentic AI. As models grow and agentic workloads demand far higher token rates, that “memory wall” has become the binding constraint.

Supply cannot catch demand quickly. High Bandwidth Memory (HBM) consumes roughly three times the wafer capacity of conventional DRAM, needs scarce EUV tools and advanced packaging, and is produced by only three suppliers. Most of next years output is already sold out. Micron’s leadership has called memory the chief constraint in AI—ahead of logic and even power. That is why memory now takes a rising share of AI capex. Until wafer and packaging capacity catch up, more compute without more memory is the most expensive configuration an operator can build. We feel the stock price can only ignore the massive opportunity ahead of the memory companies for so long before they erupt again.

SEASONALITY BULLISH, BUT INDICATORS ARE NOT

As we enter the fourth quarter of this mid-term election year, we are also entering the strongest period of the four year presidential cycle. The third year of a presidency historically has produced the strongest returns of the four years. Even more noticeable is the first quarter of year three of the presidential cycle was positive for the NASDAQ every time with a average gain of 13.1%. On top of that, this year the S&P 500 has made new highs in each of the first three quarters of this year. This has happened 20 times since 1955 and in all but one case, the fourth quarter was positive with an average return of +5.6%. Seasonality is definitely in the markets favor going forward.

Unfortunately, the market has a lot to overcome when we look underneath the hood to see how strong the market actually is. Something we have talked about in newsletters past is the Hindenburg Omen and while we do not need to get into specifics regarding this again, when many of these “omens” hit over a relatively short time frame, forward returns tend to be poor. We have had roughly 17 of these readings in the last five months and that is less than the amount we had over the previous 2 years before that.

Another negative reading out there is the fact that high yield spreads (the spread between yields on junk bonds and treasuries) have been rising which indicates higher credit risk and is associated with economic distress. This indicator is not perfect and is not necessarily timely, but something to keep an eye on.

Lastly, the amount of stocks above key moving average (a measure of market breadth) have been very weak for a couple months and continues to slide. However, in a lot of these indicators, we may be nearing washout levels and thus seasonality might very well work in the markets favor, producing a good finish to 2026.

WATCHING THE DOLLAR

The dollar had a very strong September, rising 2%, which is a big move in the currency market. Sure the dollar is just 6% from its recent lows, but it appears to be continuing a textbook bullish-to-bearish reversal pattern and 2026 in general has shown a well pronounced uptrend.

The previously discussed rate hike is helping the dollar, especially as it widened the rate gap between us the euro area, as well as other major economies.

Other factors leading to this strength are a fairly resilient US economy and a tight domestic labor market. The Euro has felt the majority of the stress from the strength as they have been a laggard due to energy shocks, geopolitical issues and very weak participation in the Ai buildout. The dollar is also benefiting from conflict in Iran as the US is a net energy exporter, so higher oil improves the export balance which supports the currency.

All is not so rosy though as a rising dollar makes our exports less competitive, which works against the intended re-shoring of jobs and makes the trade deficit even worse. As for the markets, a stronger currency tends to be a headwind to multi-national corporations, emerging market economies and gold. Gold has definitely struggled of late, so any letup in the rise of the US dollar would be a welcome event.

