Investment Strategy Outlook

NOVEMBER 2026

THE ECONOMY

Growth On Solid Ground, Persistent Inflation Remains A Concern

In last month's edition, we discussed the results of the comprehensive annual revisions to the data from the National Economic Accounts which showed faster real GDP growth over recent quarters than had previously been reported. We noted that the revised data showed the U.S. economy to be on firmer footing heading into 2H 2026 than had previously been implied. The Bureau of Economic Analysis' (BEA) first pass at Q3 GDP supports that assessment, with BEA's initial estimate showing real GDP expanded at an annual rate of 3.4 percent in Q3 after growing at a 2.2 percent rate in Q2. Real private domestic demand – combined household and business spending adjusted for price changes – grew at an annual rate of 4.9 percent in Q3 after having grown at a 4.5 percent rate in Q2.

Real consumer spending grew at an annual rate of 3.8 percent in Q3, adding 2.52 percentage points to top-line real GDP growth. While real consumer spending also grew at a rate of 3.8 percent in Q2, the composition of spending shifted, with Q3 seeing slower growth in spending on goods and faster growth in services spending, which accounts for roughly two-thirds of all consumer spending. Spending on discretionary services (such as travel, lodging, dining out, recreation, and entertainment) was particularly strong in Q3, in part a reflection of the wealth effects that have been a support for consumer spending over the past several quarters.

Real business fixed investment grew at an annual rate of 12.7 percent in Q3, adding 1.78 percentage to top-line real GDP growth. If we set aside 2020-21, when the data were being driven by the pandemic and the policy response to it, this is the largest contribution to real GDP growth made by business fixed investment since the third quarter of 2011. Real outlays on equipment and machinery grew at a rate of 20.9 percent in Q3 and on a year-to-date basis through Q3 are up 14.1 percent. While AI related investment has been the key catalyst for growth in spending on equipment and machinery, growth in such spending has become more broadly based over recent quarters. Real business spending on intellectual property products, the bulk of which consists of spending on R&D and computer software, grew at an 8.4 percent rate in Q3 while real business spending on structures grew at a 5.4 percent rate, with structures tied to power generation and energy exploration/production the main drivers.

To some extent, the strength of business investment spending is reflected in what was a significantly wider trade deficit in Q3. While real exports of U.S. goods rose at an annual rate of 5.7 percent, real imports into the U.S. rose at a 19.7 percent rate. Over the past several months, however, imports into the U.S. have been dominated by raw materials and intermediate capital goods excluding motor vehicles. While treated as a drag on real GDP growth upon arrival into the U.S., the reality is that these goods that will be ultimately be used by firms in the U.S. to produce finished goods, thus adding to real GDP growth down the line. To us, this is far more relevant than the treatment of such goods in GDP accounting. Either way, the wider trade deficit knocked 3.32 percentage points off Q3 real GDP growth.

There are some areas of concern in the Q3 GDP data. One is the contraction in residential fixed investment, the ninth quarterly contraction in the past ten quarters, reflecting the sharp decline in single family construction. With affordability constraints having become more binding with mortgage interest rates well over seven percent, builders are finding it increasingly difficult to pare down elevated inventories of spec homes for sale. We expect further pullbacks in single family construction over coming quarters while higher financing costs will likely weigh on multi-family construction. As such, residential fixed investment is likely to remain a drag on real GDP growth over coming quarters. Additionally, while the trend rate of real GDP growth has settled back into the trend rate seen over the course of the pre-pandemic expansion, nominal GDP growth remains considerably above its pre-pandemic trend. The gap between the two is a proxy for the pace at which prices are rising, and the FOMC will remain in play for as long as this sizable gap persists.

The higher frequency data show that the strength in the Q3 data carried into the final quarter of 2026. For instance, the monthly surveys of the manufacturing and services sectors conducted by the Institute for Supply Management (ISM) show continued expansion in both broad sectors. Most importantly, the ISM surveys show continued solid and broadly based growth in new orders in both the manufacturing and services sectors, suggesting further growth in output and employment in the months ahead. At the same time, however, the ISM surveys continue to show persistent and broadly based upward pressure on input prices which will continue to be reflected in broader measures of wholesale level and retail level inflation.

Total nonfarm employment rose by 165,000 jobs in October, considerably ahead of expectations, with private sector payrolls up by 159,000 jobs and public sector payrolls up by 6,000 jobs. At the same time, prior estimates of job growth in August and September were revised up by a net 84,000 jobs for the two-month period, with private sector job growth the beneficiary of the entire upward revision. October's job growth was broadly based, as the one-month hiring diffusion index,

a gauge of the breadth of hiring across private sector industry groups, rose to 57.6 percent. Average hourly earnings rose by 0.4 percent, leaving them up 3.1 percent year-on-year. Of greater relevance is that aggregate private sector wage and salary earnings, the largest block of personal income, rose by 0.5 percent in October, leaving them up 4.4 percent year-on-year, while the upward revision to private sector job growth led to an upward revision to earnings growth in August and September. The unemployment rate fell to 4.1 percent in October, keeping it within the narrow range it has occupied for some time now.

While it is hard to find much to not like in the October employment report, yet another notably low initial response rate to the monthly establishment survey raises questions as to the reliability of the initial estimates of nonfarm employment, hours, and earnings. This is an issue we have been pointing to not for months but for years. Over the past several months, we've also been pointing to what has been a high volume of seasonal adjustment noise in the monthly employment reports, which has often distorted the monthly headline job growth prints. The October employment report, however, was free of any such noise. To that point, the not seasonally adjusted data show the largest October increase in private sector payrolls since 2022, the basis for the much larger than expected increase in seasonally adjusted job growth.

As a way around what has been considerable noise in the monthly estimates of seasonally adjusted job growth, our focus has been squarely on the longer-term trends in the not seasonally adjusted data. The longer-term trend rate of private sector job growth had been notably stable since early 2025, at a rate just above what we think to be sufficient to keep the unemployment rate steady. Over the past two months, however, that trend rate has turned higher, and over the twelve months ending in October, private sector payrolls increased by an average of just under 80,000 jobs per month. Couple that with labor productivity growth having accelerated over the past three years, averaging 2.6 percent over that span, and the result is a faster trend rate of real GDP growth which, if the economy can ever break free of the supply-side shocks that have helped sustain inflation above the FOMC's 2.0 percent target, will push inflation lower. Still, the FOMC cannot overlook the fact that inflation does remain well above its target rate, and though they opted to remain on hold at their October meeting, another twenty-five basis point hike at the December FOMC meeting cannot be ruled out.

Finally, we think it worth making some brief comments on the potential impacts of the recent midterm elections, which delivered a resounding victory for the Democrats, not only on the federal level but also on the state level. It is the results on the state level that may have the bigger impact on the pace of growth of AI investment and data center buildouts over coming years. It is, however, important to note that virtually all the proposed moratoriums on data center construction pertain to projects not yet permitted without impacting those projects already permitted or already underway, a pipeline which is substantial. As such, curbs on data center construction may not become apparent in the broader economic data until 2028.

On the near-term horizon, a continuing resolution to fund the federal government must be in place by December 11 to avoid another government shutdown. While the "lame duck" Congress may steer such a resolution through, it could be a very short-term measure, leaving a more lasting resolution for the new Congress to produce in early 2027. The new Congress is also likely to attempt to restore funding cuts to various health care programs and could attempt to roll back changes to the tax code passed into law in the summer of 2025. The administration, however, still maintains veto power and the Democratic majority in the U.S. Senate will not be large enough to override vetoes without help from Senate Republicans. On the whole, however, we cannot rule out already sizable federal government budget deficits growing even wider, and the U.S. fiscal path is likely to remain a key concern amongst fixed income investors and market participants.

Source: Bureau of Economic Analysis; Bureau of Labor Statistics; U.S. Census Bureau; Institute for Supply Management

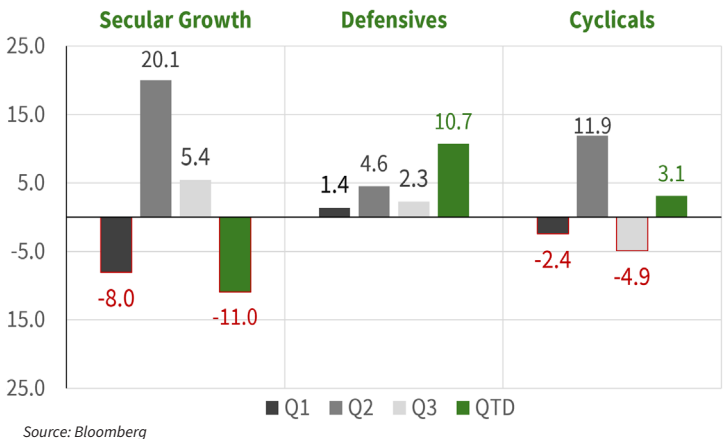
STOCKS

Post-Election Shakeout Leaves More Reasonable Expectations, Valuations In Its Wake

The S&P 500 ran in place throughout October, with the index finishing lower by less than 1%, content to remain range-bound in the lead-up to midterm elections amid lingering concerns surrounding capital raising and spending plans tied to the AI infrastructure buildout. As we approached month-end, hyperscaler earnings took center stage, and while trailing results provided few surprises, expectations surrounding growth and return on AI-related investment in most cases failed to be met. Most reaffirmed spending guidance, while Meta Platforms and Broadcom successfully and creatively tapped the equity and debt capital markets to fund future AI investments. AI angst weighed on the S&P 500 communication services and information technology sectors, with the former diving over 15% during the month and the latter dropping a less drastic but still painful 6.8%.

Interestingly, while the market capitalization weighted S&P 500 fell by 0.9% in October, the equal weight S&P 500 surged 5%, evidence that capital was both rotating within the information technology sector and being recycled across a broad swath of both defensive and economically sensitive sectors. Notably, seven S&P 500 sectors – consumer staples, energy, financials, health care, materials, real estate, and utilities – finished October with a gain of at least 5%, further evidence that weakness was mostly contained within the communication services and information technology sectors during the month.

Defensives Rally At The Expense Of Growth, While Cyclicals Bounce



Source: Bloomberg
Past performance is not indicative of future results.

The traditionally defensive consumer staples, health care, and utilities sectors led as all three sectors rose at least 9.5% during October, but the improvement in economically sensitive sectors such as consumer discretionary and financials may be more noteworthy as energy prices and interest rates remained elevated at month-end. Defensives typically perform well on a relative basis in the lead-up to midterm elections, so we aren't surprised by strength out of those sectors. But we take note when industries and/or sectors perform differently than our expectations. For instance, consumer discretionary stocks rallying alongside energy stocks and crude oil last month and financials rebounding and garnering inflows amid a sharp move higher in Treasury yields and mounting expectations for further monetary policy tightening are two such examples that leave us a bit more constructive on economically sensitive sectors.

Following a post-election pullback, some pockets of the information technology sector could also stand to benefit as market participants sift through the rubble to find bargains following what appeared to be forced selling and de-leveraging in the back-half of October and into early November. Specifically, some tech-heavy hedge funds were rumored to have received margin calls and some high-profile shops shuttered funds and returned capital to stakeholders. However, we would look to Anthropic's closely watched IPO later this month as a potential harbinger of things to come for technology stocks. An oversubscribed and well received offering could bring enthusiasm and capital back to the AI trade, while a lackluster listing could embolden skepticism surrounding the outlook for capital spending and the potential payback on these investments.

With the benefit of perfect hindsight, U.S. equity indices did a fairly good job handicapping the midterm elections. From the end of June through the end of October. technology stocks were sources of funds as the sector was viewed as the most exposed and potentially the most negatively impacted should a "blue wave" materialize and the pace of the datacenter buildout slow materially. But with defensives carrying the leadership baton in recent months and now trading at lofty valuations for slow-growth businesses, broadly speaking, and with the selloff in secular growth areas tied to the AI buildout shaking leverage out of the system and bringing about more reasonable valuations and expectations following the midterms, we would look to take the other side of these positions. Broadly speaking, we remain constructive on U.S. stocks into the new year.

Value Outpacing Growth Farther Down The Market Cap Scale As Well. Another area worth watching is U.S. small and mid-cap (SMid) stocks, which held up surprisingly well in October despite Treasury yields moving higher, credit spreads widening, and prices on a broad swath of inputs remaining elevated. The S&P Small Cap 600 index, which is viewed as a 'higher quality' small cap index due to profitability requirements, gained 3.1% during the month, while the Russell 2000 index, which has no profitability requirement for inclusion, rose a more modest 0.5%. Another telling divergence has emerged between small cap growth and small cap value indices, with the Russell 2000 Growth falling by 2.2% in October while the Russell 2000 Value posted a 5.4% gain during the month. The cyclical tilt within the value index has been the primary source of differentiation as higher exposure to financials and energy provided a boost. Domestic SMid is a segment of the stock market that performed much better than we would have expected in the face of persistent headwinds throughout the month, and while it could've have just been an oversold bounce, this cohort of stocks could be set up to reprice higher early in 2027 if Treasury yields and energy prices have peaked. We would prefer to stay up in quality when allocating to domestic SMid to limit the magnitude of any drawdown that might materialize should both variables shift in a less favorable direction.

Election-Related Weakness In Brazil Relatively Contained, But AI-Related Names Weigh On Emerging Market Indices. The MSCI Emerging Markets (EM) index benefited from its high correlation to chipmakers earlier this year, but that relationship weighed on the index last month as it suffered an 8% decline. Latin American stocks that were a ballast last quarter became a pain point for the broader MSCI EM index last month as a surprise in the Brazilian Presidential runoff election suggested a less constructive outlook for the country's stock market. Unsurprisingly, the MSCI Brazil index was one of the worst performers within the index as it declined 12% in October, but we can't ignore the run-up pre-election that leaves the country index up by 4.1% for year to date. This is an invaluable reminder that concentration and overconfidence in an outcome can create unnecessary risk, even if election outcomes are often less material than markets predict.

The MSCI EM benchmark finished the month over 13% below its June high, in correction territory and below its longer-term moving averages. From a technical perspective, the change in momentum shouldn't be ignored, and while investors are rotating within domestic equities, emerging markets don't offer the same sector diversification that can be found within U.S. indices. The lack of attractive companies in a wide array of sectors has forced market participants to expand their horizons to developed international markets, evidenced by the MSCI EAFE falling just 0.5% in October. The MSCI EAFE appears to be taking up where the EM index left off as the developed benchmark spent most of October moving sideways with buying pressure building late in the month. For now, there isn't enough momentum behind the MSCI EAFE to consider shifting more capital in that direction, but we're on watch for a potential positive trend change as volume is ticking higher beneath the surface. ▲

BONDS

Yields On Long-Term Treasuries Back To The Scene Of The Breakout

U.S. Treasuries rallied over the back half of October as market participants flocked to safety and quality amid signs of escalation in the Middle East and continued uncertainty surrounding the outlook for AI-related capital raising and investment. After the 10-year Treasury yield jumped to an intra-day high of 5.35% in early October, buyers appeared eager to take advantage of the back-up to lock in higher yields, which forced the 10-year yield back to 4.94% by month-end. In our view, a retracement of this magnitude in such a short period of time isn't a coincidence and appears largely technically driven as the initial breakout in the 10-year yield that began in mid-September started around this level. The sharp move higher in yields from mid-September into early October appeared to

be largely positioning driven as hedge funds built up sizable short positions in long-term Treasuries, forcing yields higher in the process, but lingering concerns surrounding massive AI-related corporate bond issuance in the quarters to come played a supporting role. The 5.35% area on the 10-year Treasury was a logical spot to take profits and cover short positions as that was also the peak for the 10-year yield way back in 2007. From the look of it, this could remain a staunch resistance point on the upside for the 10-year yield.

Following short covering in Treasuries as October ended, hedge fund positioning, in aggregate, appears to be closer to neutral, whereas 'max short' long duration bonds was the positioning mid-month. But with this cohort of deep-pocketed investors back on the sidelines, it could take either cooler inflation data and/or signs of trouble brewing for the U.S. economy for them to get long Treasuries and force yields meaningfully lower. Regarding corporate issuance potentially crowding out demand for Treasuries, this concern appeared to subside in the back-half of October as the sharp rise in Treasury yields and widening of credit spreads on corporate bonds led to some deals being downsized or pulled entirely.

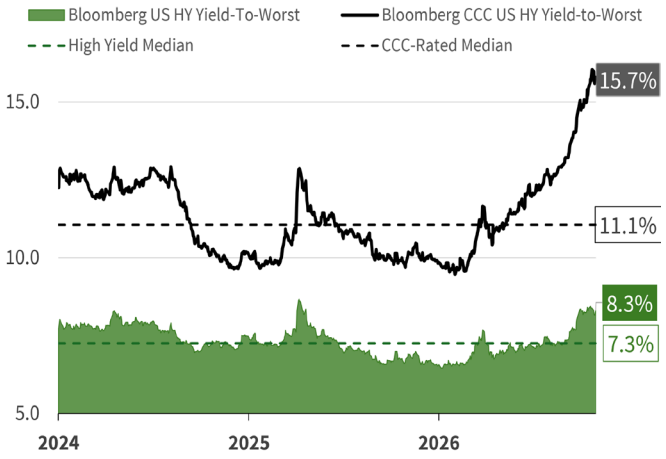
Corporate bond issuance has slowed from what was a torrid pace in the first nine months of this year as AI funding concerns have dominated headlines, but new deal activity could ramp up relatively quickly in the new year as companies look to take advantage of the drop in yields. Given the size of projected AI-related investment in the years to come, corporate issuance will likely remain elevated and credit spreads could widen further as investors seek higher yields to adequately compensate them for taking on credit risk related to this buildout. In short, competition for capital coming from corporate bonds isn't going away, which will likely limit how low yields on Treasuries can go.

U.S. Treasuries, broadly speaking, are trading closer to fair value after starting to look cheap in the back half of October. Investment grade corporate bonds are trading at yields of around 90-basis points above similar duration Treasuries, leaving high grade corporates looking a bit more attractive at the margin for investors willing to take some credit risk. At the end of October, credit spreads on riskier, higher yielding corporate bonds rose to levels not seen since "Liberation Day" in April of last year, but remained tight by historical standards at the index level as weakness was largely isolated to lower rated CCC-rated credits. With the Bloomberg U.S. Corporate High Yield index carrying an 8%-plus yield, should risk appetite and sentiment improve into year-end, we could see a nice rebound out of this segment which saw a painful recalibration in September and October. We maintain positions in-line with our strategic neutral exposures as we still wait for a 'fat pitch' to be presented to tactically adjust portfolios.

High Yield Bonds Running In Place, But Waning Debt Issuance Should Ease Funding Concerns. Investors in below investment grade credit didn't get the commensurate bounce-back that materialized for investment grade corporate bonds last month, as price appreciation was largely driven by the fall in Treasury yields. High yield bond valuations closed out October at a new year-to-date high of 340-bps over like Treasuries, an ominous headline if taken at face value, but the index's yield-to-worst was lower on the month—we just didn't see prices appreciate as much as they did in higher quality bonds. That lack of price appreciation is evident in the total return numbers, with the Bloomberg U.S. High Yield index higher by 0.3% while the Bloomberg U.S. Corporate index, which is entirely investment grade, rose by 2.2% even as the former carried an 8.3% yield-to-worst at the end of October.

Not every segment of the high yield market saw higher prices In October as yields on low-quality CCC-rated bonds moved higher for the sixth consecutive month, landing at 15.7%. Credit spreads on this cohort of bonds made new 5-year highs early in November and had surpassed their 2022 highs at the time of this writing. That divergence is telling as individual names are expected to see considerable stress, but we're not seeing funding concerns push prices of bonds lower in a wholesale manner, which is perhaps at odds with most market headlines. Trading and new issuance activity was healthy last month with only $14.6B in new paper coming to market in October, as issuers held back offerings in anticipation of calmer seas ahead. That lack of supply may increase demand in the months to come and revive risk appetite in the near-term, but credit market participants will continue to monitor BB- and B-rated spreads for any signs of broader contagion. ▲

Lowest Rated High Yield Bonds Under Stress, Unlike The Index



Source: Bloomberg
Past performance is not indicative of future results.

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