October 2026

MONTHLY MARKET INSIGHTS

Key takeaways:

- Leading AI stocks held up the S&P 500, which closed down only 0.45%, while the equal-weight S&P fell 4.99%, its widest gap with the headline index since March 2020[1]
- The FOMC raised the policy rate 25 bps and the 10-year Treasury yield rose to 5.29%[2] with real yields accounting for nearly all the move
- Brent moved back above $100/bbl for the first time since July amid renewed escalation in the Middle East, including a drone strike that temporarily disabled a crucial pipeline

Rising rates set the tone for markets in September, and the AI leaders were among the few able to withstand them. The 10-year Treasury yield rose 54 bps to 5.29%, Brent crude rose back above $100/bbl for the first time since July, the Fed hiked 25 bps, and yet the headline S&P 500 lost only 0.45%, closing the month less than 2% below all-time highs. The top of the index provided much of the cushion, with the Mag 7 delivering a 4.18% gain for the month, driven by a surge from Meta on the release of its Muse AI agent. However, the equal-weight S&P diverged drastically from the market cap-weighted index, finishing down 4.99% on the month, the widest spread since March 2020. The small-cap Russell 2000, comprised of companies that primarily finance themselves with floating-rate debt, lost 5.40%. Sector-wise, Tech (+4.42%) and Communication Services (+4.26%) led, while Financials (-7.28%) and Materials (-6.93%) were the laggards.[3] With no fundamental catalyst to anchor the market ahead of earnings season, hawkish central banks, higher rates, and geopolitical headlines hit the rate-sensitive areas of the market, while the AI leaders held firm.

The split between the top of the index and the rest can be traced back to the continued AI infrastructure buildout, which has substantially driven economic growth and a rally in the stocks tied to it. In GDP terms, the AI buildout is shaping up to be the biggest single economic bet in US history at its current pace. AI investment is set to hit 1.9% of GDP in 2026, reaching a share of the economy last seen during the 19th-century railroad boom.[4] The September PMI rose to its strongest reading in more than five years on the back of a broad acceleration in new orders, activity, and employment. The Atlanta Fed's GDPNow forecast is currently tracking to 3.7% real GDP in 3Q, or 7.1% nominal. In that light, the move in long-end yields makes sense. After breaking through the 5% mark in the middle of the month, the 10-year continued its push upward. Over long horizons, the 10-year converges toward trend nominal growth. The logic is that the government must offer investors roughly what they could earn in the economy to sell its bonds. That relationship broke down after the GFC, when QE and a negative term premium held yields below nominal GDP for over a decade, so the current move may be seen as a normalization. Despite large moves in oil and refined products, the 10-year breakeven, a proxy for long-run inflation expectations, rose just 4 bps, while the 10-year TIPS (real) yield rose 50 bps.[5]

1. Bloomberg.
2. Id,
3. Id.
4. Putzier, Konrad, and Justin Lahart. "The AI Build-Out Is Becoming the Biggest Economic Bet in U.S. History." The Wall Street Journal, 23 Sept. 2026, www.wsj.com/economy/the-ai-build-out-is-becoming-the-biggest-economic-bet-in-u-s-history-c60716dd.
5. Federal Reserve Bank of St. Louis.

The current move in rates is unlikely to deter the AI buildout. AI projects underwritten at high returns can absorb the higher cost of debt, so the largest issuers have not found the run-up in rates restrictive yet. But some businesses may find marginal projects harder to justify as borrowing costs rise, which may explain the selloff in rate-sensitive areas. Hyperscalers initially funded capex from operating cash flow, but with capex now exceeding cash flow from operations, they have increasingly tapped debt and equity markets. Estimates call for $400 billion of hyperscaler debt issuance in 2027 as the share of debt-funded capex reaches a peak of 35%.[6] As debt funds a growing share of the buildout, rates will eventually matter. The signs to monitor are hyperscaler credit spreads, new-issue concessions, and revisions to capex guidance.

Fed Chair Warsh noted the effect of hyperscaler debt issuance on rates at the abbreviated press conference following the FOMC's unanimous decision to hike 25 bps.[7] The Chairman emphasized a continued commitment to price stability, and the summary of economic projections (SEP) showed core PCE at 3.4% in 2026, with no return to 2% until 2029.[8] Markets have priced in three additional 25 bps hikes by the end of 2027.[9] Other major central banks, including the European Central Bank, Bank of England, and Bank of Japan, are expected to keep hiking as well. The dollar posted its largest monthly gain since March, with the DXY up 2.04%, as US yields repriced faster than those abroad and geopolitical risk drew haven demand. On the back of higher rates and a stronger dollar, gold fell 6.04% in September.[10]

Geopolitical risk added another layer to the month's cross-currents. The situation in Iran remains fluid and continues to drive near-term inflation, though as noted above, that pressure has yet to feed through to long-run inflation expectations. Yemen's Houthis took over a swath of land on the coast of the Bab el-Mandeb Strait, while an Iranian-backed militia launched a drone attack from Iraq that struck and temporarily knocked out the Saudi East-West Pipeline, which has been a major off-ramp for oil exports out of the Arabian Peninsula since the closure of the Strait of Hormuz. Iranian control of the Strait of Hormuz appears to be loosening as oil exports have picked up despite the negative headlines and aggressive posturing. Flows through the East-West Pipeline have been restored, and regional oil exports are now just 11% below pre-war levels, averaging 20.5 mbd over the past 10 days.[11] The recovery has been uneven, however, with crude exports back to 98% of pre-war levels, while refined product exports such as diesel, gasoline, and jet fuel remain at just 58%.[12] With crude largely flowing again, Brent's hold above $100/bbl mostly reflects a geopolitical premium, while the shortfall in refined products has kept pump prices elevated.

Diplomacy offers the clearest path to unwinding that premium. The UN General Assembly provided diplomatic cover for discussion between the US and Iran. One view is that Iran's political leverage has reached its peak with the midterms approaching, as elevated oil prices are a key issue for voters. That leverage would likely diminish once the election passes, giving Tehran an incentive to negotiate before November while on strong footing. If the window passes, however, the path to a lasting pause becomes less clear. An agreement could push oil lower and ease pressure on inflation and rates; without one, the risk premium in energy prices is likely to persist. On the other major geopolitical front, President Xi Jinping's state visit to Washington produced few headlines beyond an extension of the trade truce until January. With tariffs still elevated and few details on next steps, trade remains an area of caution.

6. Hammond, Ryan. "AI capex, required revenues, and what's priced in the AI trade." Goldman Sachs, 24 Sept. 2026, publishing.gs.com/content/research/en/reports/2026/09/24/17991761-4354-496a-bf3a-26b281c829fc.html.

7. Putzier, Konrad. "Warsh Partly Blames AI Spending for Higher Long-Term Rates." The Wall Street Journal, 16 Sept. 2026, https://www.wsj.com/livecoverage/fed-meeting-warsh-interest-rate-09-16-2026/card/warsh-partly-blames-ai-spending-for-higher-long-term-rates-FiFZsBsLVrI6tCj6YWjD?mod=Searchresults&pos=1&page=1.

8. Board of Governors of the Federal Reserve System. Summary of Economic Projections. Federal Reserve, 16 Sept. 2026, www.federalreserve.gov/monetarypolicy/fomcprojtabl20260916.htm.

9. CME FedWatch Tool.

10. Bloomberg.

11. Kaneva, Natasha. "Oil Flash Note." J.P. Morgan, 29 Sept. 2026, markets.jpmorgan.com/research/email/scx/-ai7hugd/GPS-5466002-0/0d3642a2-1ddb-46a5-af2f-a457816ca302.

12. Id.

13. Cheng, Evelyn. "US and China Agree to Extend Trade Truce, Bessent Says." CNBC, 24 Sept. 2026, www.cnbc.com/2026/09/24/us-china-trade-truce-bessent-trump-xi.html.

With September behind us, October brings a dense calendar of catalysts. Midterm rhetoric will pick up ahead of the November 3rd elections, with campaigns focused on affordability and AI data centers. As it stands, Kalshi gives Democrats a 61% chance of winning majorities in both the House and Senate, an outcome that would return Washington to a divided government. The FOMC meets again in the last week of October, with markets currently pricing an 83% chance of a hold.[14] Third quarter earnings season could give markets the fundamental anchor that was missing in September, with consensus expecting S&P 500 year-over-year earnings growth of 29.1%.[15] The big banks kick things off in mid-October, while the hyperscalers round out the end of the month with capex guidance in full focus.

Market breadth deteriorated considerably in September. The AI buildout continued to power growth at the top of the index, while higher rates, hawkish central banks, and geopolitical risk weighed on nearly everything else. The AI buildout looks durable and the fundamentals behind it remain strong, but the wide gap between the headline and equal-weight indices is a reminder of how concentrated returns have become. With earnings poised to provide the anchor September lacked, we remain constructive in the short term, favoring diversification as the most prudent approach.

14. CME FedWatch Tool.

15. FactSet, Earnings Insight, September 25, 2026. https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_092526.pdf

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