

Aptus Market Outlook: Q3 2026 Highlights

A Quarter About Rates, Carried by Profits

Fixed income took center stage this quarter for all the wrong reasons as bonds sold off hard and the 10 year Treasury yield climbed to 5.3%, its highest level since 2007. The aggregate bond index lost more than 3% and investment grade credit fell close to 5%, leaving the asset class many investors treat as the safe side of the portfolio as the quarter's primary source of losses. Treasuries traded more like risk assets than stocks did, with the MOVE index rising roughly 40% over the final two weeks while the VIX held flat. Rate sensitive corners of the equity market felt the pressure too, with small caps down about 7% and utilities and real estate selling off sharply, yet the S&P 500 still finished the quarter up nearly 3% as a reminder that profits matter as much as rates.

Earnings Strength and an Asset-Heavier Market

S&P 500 earnings are expected to grow roughly 23% in 2026 and that growth has absorbed the headwinds from the Iran conflict, higher oil prices, and rising rates. Returns this year have come from earnings while the valuation multiple contracted from about 23 times forward earnings at the start of the year to roughly 19 times today. The lower multiple has less to do with geopolitics or the Fed than with capital spending, since hyperscaler capex is now projected near \$760 billion this year rather than slowing as investors expected, leaving the S&P 500 a more asset heavy index than it was a year or two ago. That creates two paths to upside, because a return on the spending can lift both earnings and multiples while a slowdown in spending would flow straight to free cash flow. Beneath the index the average stock sits about 20% below its peak, which shows how much strong hyperscaler results have insulated the headline return.

Rising Yields Reflect a Policy Readjustment

Since the Iran conflict began at the end of February, the 2 year Treasury yield has risen 151 basis points, the 5 year 159 basis points, and the 10 year 135 basis points in a broadly parallel move that oil alone does not explain. Growth expectations and the neutral rate have climbed with nominal GDP running above 8%, while term premium keeps building as fiscal imbalances go unaddressed. Inflation breakevens have stayed flat, a sign that markets are not pricing in runaway inflation. After 75 basis points of cuts last fall, the current move reads as a policy readjustment to a strong economy rather than the Fed or Treasury losing control. The starting point also differs from 2022, since at current yields the 5 year Treasury would need to rise roughly 138 basis points over the next year to produce a negative total return. That makes bonds less bad, though it does not make them good.

Fiscal Dominance and the Real Hurdle Rate

Whether bonds become investable comes down to nominal growth, where the spread between nominal GDP and the 10 year yield has averaged about 71 basis points over recent decades and sits near 300 basis points today. With debt above 100% of GDP and government issuance now larger than private lending, rate hikes behave differently than they did when debt to GDP stood near 30% to 35%. Higher rates raise income

for savers and asset holders while many households sit on locked in 3% mortgages, which can make hikes more stimulative than restrictive. Household balance sheets are in strong shape, with even lower income cohorts materially wealthier than before COVID. If yields reach a tipping point, policymakers are likely to step in through larger buybacks at the long end, reduced long duration issuance, or balance sheet support, protecting the Treasury market ahead of the currency. For investors focused on real after tax returns, the hurdle rate sits well above 2%.

Oil and Midterms: The Old Playbooks No Longer Apply

Oil above \$100 has not dented S&P 500 profitability and remains well below the 2008 peak, which would equal roughly \$210 today after adjusting for inflation. The US has shifted from a net importer through 2015 to one of the world's largest exporters and energy accounted for less than 2% of household disposable income entering the year versus more than 5% in 2008. Flows through the Strait of Hormuz also appear much closer to their levels before the conflict than early fears suggested, though international economies remain more exposed than the US. On the political front, data centers have become a bipartisan sentiment risk heading into the midterms. Sentiment driven pullbacks have historically averaged about 8% compared with 16% to 17% for growth scares. This year's maximum drawdown of roughly 9% is about half the midterm year average near 19% and the fourth quarter of a midterm year has historically been the strongest, averaging about 6.6%.

Portfolio Strategy and Risk Management

The allocation remains strategic and built around owning more stocks and fewer bonds while staying risk neutral. Tilts reflect long term conviction rather than positioning for a single quarter, earnings season, or Fed decision. Options based strategies make that stance possible by allowing portfolios to hold more equity while managing left tail outcomes. Calm equity markets have left the cost of hedging as inexpensive as it has been in some time, so portfolios remain well positioned even if higher rates eventually pressure the economy. What would warrant a less constructive view is rates staying elevated for an extended period, slowing AI growth, renewed inflation pressure, or markets testing a Fed under Chair Warsh that no longer offers forward guidance. Absent those, earnings and productivity continue to favor risk assets heading into what has historically been the strongest stretch of the year.

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