

Doll's Deliberations®

Weekly Investment Commentary



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Summary

Stocks rose last week (S&P 500 +1.17%). Equal weight was up for the first time in eight weeks even though the Russell 2000 was down for the fifth straight week. Some signs of rate stabilization and improving breadth were encouraging. Best sectors were consumer staples (+3.99%), utilities (+3.97%), and energy (+3.62%); two sectors were negative on the week: industrials (-0.40%) and technology (-0.25%).

Key takeaways

1. The U.S. economy is in solid shape; recent data indicate that U.S. economic momentum is improving on the back of resilient consumer spending and broadening gains in manufacturing activity and business investment. Solid growth has inevitably boosted inflation, which in turn has forced the Fed to pivot lifting its policy rate, and has contributed to a major rise in long-term bond yields.
2. At some point, an economic slowdown will become increasingly likely, given persistently higher oil prices, central bank tightening, higher long-term rates, and the U.S. financial impulse turning negative. But the slowdown is still likely not a recession because: 1) Credit conditions look reasonably benign, 2) consumer net worth is rising, 3) firing remains restrained, 4) gig work is still available, 5) new business formation is up, and 6) trend productivity growth is accelerating.
3. Monetary policy may appear loose when considering some financial market indicators (e.g., equity market valuations), but it has been in restrictive territory for the U.S. housing sector.
4. Global debt issuance as a percentage of global GDP is expected to jump this year to 23.3% (up from 17.5% in 2019). The only times it was close to this year's high were periods of recession or crisis.
5. Investor concerns about the fiscal and economic outlooks in France have mounted, along with rising bond yields. France remains a weak link that needs to be monitored.
6. Bond bullishness is now in the 5th percentile over the last 10 years.
7. The earnings yield using a 19x forward P/E is 5.26%, virtually identical to the yield of the 10-year Treasury. This makes bonds equivalent in valuation attractiveness to equities for the first time in two decades.
8. The explosive pace of S&P 500 earnings growth is poised to slow in the coming quarters, as companies lap tough year-over-year comparisons, and the factors that have boosted corporate profits this year fade in strength.
9. Information technology's share of the S&P 500's market cap rose to a record 39.3%, above the 2000 peak of 32.9%. The difference this time is earnings. IT accounts for 36.3% of the index's forward earnings, a gap of just 3.0 percentage points. At the 2000 peak, the gap was 17.5 points.
10. From mid-August to Oct. 6, the technology sector is +9%, while eight other sectors are -3% or worse and five are -5% or worse.

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	0.96	8.80
S&P 500	1.17	15.14
NASDAQ	0.65	18.28
Russell 1000	0.55	14.07
Russell 1000 Growth	0.68	8.59
Russell 1000 Value	1.68	22.00
Russell 2000	-1.36	13.61

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	0.86	5.03
Consumer discretionary	3.13	-1.68
Consumer staples	3.99	10.17
Energy	3.62	48.45
Financials	2.38	1.23
Health care	2.84	11.79
Industrials	-0.40	10.05
Information technology	-0.25	30.40
Materials	1.43	11.02
Real estate	1.83	6.97
Utilities	3.97	-0.94

Sticky Inflation Will Eventually Cause More Problems for Markets

It appears as though the rise in government bond yields has been driven by the real component, reflecting an upgrading of economic expectations, as growth has been persistently better than was envisioned at the start of the year – both in the U.S. and globally. The consensus entering 2026 was that developed-market central banks would need to lower policy rates this year. As recently as late February, 10-year Treasury yields were just 4% and investors were forecasting a Fed funds rate of 3% in one year's time.

Global economic growth has been resilient in the face of yet another new jolt this year (the Middle East war and related energy shock.) Moreover, activity has recently improved further: PMI surveys show broad-based gains with current readings consistent with solid growth. Consequently, bond investors have reversed their economic expectations, pushing up bond yields, and most central banks have lifted their policy rates, with markets expecting further rate hikes in the next 12 months.

However, investors have not yet bet that better growth will lead to higher inflation, as inflation compensation measures have stayed calm. There has been considerable complacency since inflation has stayed above central bank targets in most countries for five years. While prospects for a pause in the relentless rise in bond yields could soon develop, the resilience of equity markets in the face of much higher yields and the new high in the global stock/bond ratio warn that yields have not yet overshot. Some cracks have appeared in credit markets, but are not yet large enough to signal an imminent peak in bond yields or significant setback in equity markets. However, government bond yields are now oversold, and most agree that the source of higher yields has been in the real component. This “calmness” reflects the deeply entrenched bias among many bond investors, encouraged by complacent central banks, that even when an inflation uptrend is underway, inflation will “always return to 2%” without the need for a recession.

The structural backdrop for inflation started to shift in the second half of the 2010s and has tilted even higher in terms of inflationary pressures this decade. Waiting for “gravity” to pull down inflation without weak economic growth is likely going to continue being a losing bet.

With regard to government finances, there are three points worth noting: 1) that massive budget deficits have occurred at a time of low unemployment rates and generally good growth is unprecedented, 2) that massive deficits have also occurred from a starting point of very elevated debt levels in most of the DM world is also worrisome, and 3) that the rapid deterioration in government finances is not generating massive political backlash is worrisome.

Conclusion

The upward pressure on global bond yields has intensified. However, bond markets are now oversold, implying good odds that yields will soon consolidate before another upleg occurs. Our expectation has been that bond yields will eventually rise to the point where something breaks; namely, risk-asset markets crack, followed by, at a minimum, an economic growth scare. As mentioned above, some credit stresses have started to emerge.

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	0.03	13.58
MSCI ACWI EX U.S.	-0.94	12.66
MSCI EAFE	-1.15	8.01
MSCI EM	-0.58	22.95

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	0.41	-2.46
Bloomberg U.S. Corp. High Yield	0.14	0.29
Bloomberg U.S. Gov/Credit	0.42	-2.43
Bloomberg U.S. T-Bill 1-3 Month	0.04	2.84

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	-0.34	6.37
Commodities (DJ)	1.79	35.01
Global listed private equity (Red Rocks)	0.20	-13.34
Currencies (DB Currency Future Harvest)	0.48	12.05

Source: Bloomberg as of 10/09/26

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