Cetera

Quarterly Outlook

Q4 2026

At-A-Glance

Third-quarter GDP growth estimates point to a pickup, with the Atlanta Fed's GDPNow model tracking near 4.4%, though consensus sits closer to 2.5%, a pace expected to carry into the fourth quarter.

Headline CPI held at 3.4% year-over-year in August, driven by a 27.4% year-over-year jump in gasoline prices, while core CPI eased to 2.4%, its lowest reading since March 2021, a split between energy-driven and underlying inflation that will shape how much room the Fed has in the fourth quarter.

The unemployment rate remained steady near 4.1% through August, keeping the labor market stable heading into Q4.

The Fed raised rates on September 16, the first hike since 2023, lifting the fed funds range to 3.75%–4.00%.

Second-quarter S&P 500 earnings growth came in near 52%, far above expectations of 18% at the start of the quarter, setting a high bar for third-quarter results (estimated near 29%), and for expectations heading into Q4.

The 10-year Treasury yield breached 5% for the first time since 2023, driven by persistent inflation, heavy debt issuance, and rising oil prices

Equities Under the Weight of Yields

The third quarter tested the durability of the U.S. economy, and it largely held up. The war in Iran continued, driving oil prices past $100 a barrel and keeping headline inflation stuck near 3.4% even as core inflation continued to cool. Economic growth data sent mixed signals as first-half GDP came in soft but the Atlanta Fed's real-time tracking model points to a sharp third-quarter acceleration, with consensus estimates still calling for a solid expansion. Labor market growth has picked up this year, and the economy that many expected to buckle under geopolitical pressure instead kept moving forward.

Once again, corporate earnings did the heavy lifting. Second-quarter S&P 500 earnings growth came in near 52%, propelled by outsized results from a handful of mega-cap technology names and the continued AI infrastructure buildout. Full-year 2026 earnings estimates have been revised sharply higher as a result, and third-quarter growth is now projected near 29%. That is an extraordinary run, but it raises the same question we flagged last quarter: expectations have climbed and a market pricing in near-uninterrupted upside earning beats leaves little room for disappointment heading into year-end.

In fixed income, the pause we described last quarter gave way to action. The Fed raised rates for the first time since 2023, lifting the fed funds range to 3.75%–4.00% under new Fed Chair Kevin Warsh. The Fed's own projections call for one more hike this year and a hold through 2027, but bond markets are pricing in a more aggressive path, and that gap is itself a source of uncertainty. The 10-year Treasury yield breached 5% for the first time since 2023, and credit markets have largely absorbed the move, with high yield spreads remaining tight even as scrutiny of private credit has intensified.

Looking ahead to the fourth quarter, two questions need to be answered: whether the war in Iran de-escalates enough to relieve pressure on oil and inflation, and whether the Fed's own rate path, or the market's more hawkish expectations, proves closer to reality. A resolution on either front would ease pressure on yields and give equities more room to work through their elevated expectations.

The overall outlook remains constructive, but risks are bubbling up. The Fed, the war, a high earnings bar, and midterm election noise are risk to navigate in the quarter. The economy is on solid ground, and earnings continue to surprise to the upside, but with yields at multiyear highs and earnings expectations so high, staying diversified matters more than positioning for any single outcome playing out cleanly.

For a quicker look at our views on the economy and markets, please see the [Summary Version of our Q4 2026 Market Outlook].

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Economy

Negative headlines often lead the news cycle. We have geopolitical uncertainty in the middle east with the war in Iran continuing. This is causing oil prices to rise, which is increasingly starting to impact inflation in other parts of the economy. While these are problems, the underlying consumer remains resilient and is keeping economic growth churning along.

Real gross domestic product (GDP) growth in the United States after accounting for inflation was 2.1% in the first quarter and 1.5% in the second quarter. We will not get a reading on the third quarter until the end of October. The Atlanta Fed publishes a forecasting model called the GDPNow in an attempt to estimate GDP growth in real time. They currently estimate third quarter real GDP growth to be 4.4%. This may be on the high side and get revised down, but the consensus estimates are still around 2.5%, which continues to fit the narrative of modest economic growth despite the uncertainties we are seeing globally. London based economic firm, Capital Economics, estimates 2026 U.S. economic growth to be 2.3%, up from 2.1% last year.

The economy appears to be on solid footing, but there are several risk factors in the fourth quarter. Uncertainties around Fed policy and artificial intelligence spending loom in the quarter.

Fed Policy (Geopolitics and Inflation)

The Federal Reserve's new chairperson, Kevin Warsh, is leading the Fed at a time when future interest rate policy is uncertain, and the Fed is divided on what to do. At the same time, he doesn't believe as much as his predecessors did in forward guidance, signaling to markets what the Fed is thinking before they act. Since the 2008 Financial Crisis, the Fed has been more transparent about what their future moves would be.

Going into the year, one of the biggest concerns was the weakening labor market. The Fed was widely expected to cut rates at some point in the year to provide support. The Fed has a dual mandate to keep full employment and price stability. Since the war in Iran started in late February, oil prices have been on the rise and now inflation is a concern. With the unemployment rate at a respectable 4.1%, and the labor market stabilizing, the Fed has switched gears and is now raising interest rates instead of cutting rates to curb inflation.

This is a risk, because the labor market still seems relatively fragile as job growth has been relatively weak, and if the Fed slows the economy by raising rates, the labor market may face headwinds. In addition, the inflation the Fed is largely trying to combat is supply side inflation caused by the war in Iran. We have said this before, but it bears repeating, raising rates will not open the strait of Hormuz and lower oil prices. Additionally, energy-related inflation will likely go away once the war ends, though uncertainty persists as to how long supply constraints will persist. The problem is that the rising oil prices are starting to impact other parts of the economy as diesel prices and jet fuel prices are increasing and the cost of goods and services will soon follow.

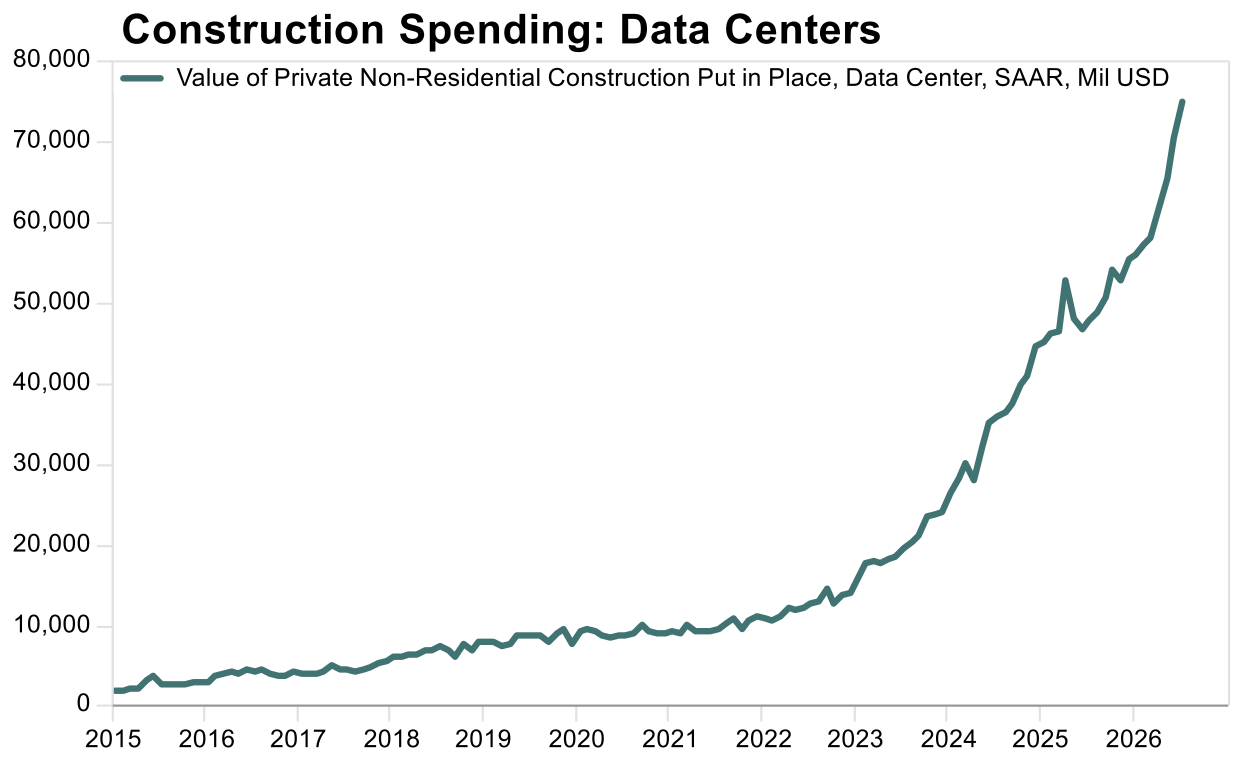
When this happens, it could be a matter of time before workers start demanding more money to keep up with inflationary pressures. That would be the final piece of the inflation feedback loop that the Fed is trying to avoid, so they felt they needed to act sooner than later, but that comes with risks. You can see the dilemma, and it comes at a time when the Fed is opting for less communication, which will likely add to market volatility.

Artificial Intelligence Spending

Another risk factor that also has implications for the Fed and inflation is the AI buildout. There are risks that the pace of spending on artificial intelligence will slow. While the long-term impacts from artificial intelligence will likely be deflationary, it is currently causing inflation as companies compete for electronic components and equipment. If spending does slow, this inflation will fall and the economy could cool, adding even more downward pressure on broader inflation. While this has been a concern for a while, recently there has been increasing concerns around artificial intelligence controls and major industry figures are calling for more regulation and slowing down the speed of development.

The AI buildout is surging. Data center construction spending rose 6% in July to a record $75.2 billion (annualized), roughly 57% above year-ago levels. Broader AI-related infrastructure spending remains strong as seen in **Figure 1**.

Figure 1:



Source: Cetera Investment Management, FactSet, U.S. Census Bureau. Data as of 7/31/2026.

The risks weighing on the U.S. economy this quarter extend globally. The Iran war is hitting energy importing economies hardest, and growth is diverging sharply elsewhere. China is slowing on oil and structural headwinds, India still outpacing peers, and Europe largely missing the AI-driven tailwind that's lifting other tech-linked economies. Add in the USMCA renegotiation and ongoing tariff fragmentation, and the same risks we flagged at home including a wider middle east conflict, an AI spending pullback, and renewed trade tensions, are what could move the global picture by year-end.

To sum it up, the U.S. economy remains on solid footing, with GDP growth holding around 2–2.5% and unemployment steady at 4.1%, but two risks loom this quarter. New Fed Chair Kevin Warsh has pivoted from rate cuts last year to renewed hikes to combat persistent inflation amplified by rising oil prices, though higher rates won't fix energy inflation and could reverse this year's rebound in labor market growth. Meanwhile, surging AI infrastructure spending is adding to inflation pressures, and any potential slowdown in that spending amid growing calls for AI regulation could cool the economy further.

Equity Markets

The good news is that the economy appears to beholding up well, but as we hit the final stretch of 2026, stocks will face some headwinds. The economic risk factors such as the AI buildout, inflation, and the Fed's response all have potential to weigh on equities. Additionally, we could see volatility related to rising bond yields and the midterm elections. Earnings expectations are also elevated, leaving less room for disappointment.

Rising Bond Yields

The biggest risk factor that has emerged may be rising bond yields. The 10-year Treasury yield breached 5% and is beginning to weigh on stock returns. You may be wondering why we are talking about rising bond yields in the equity section, but they can sometimes be correlated. We will talk more about our outlook on bonds in the fixed income section, but as bond yields rise, borrowing becomes more expensive for corporations and mortgage rates also rise. This has an impact on stock valuations.

Companies don't even have to borrow more to see earnings fall. Often, like the Federal government, when debt comes due, companies issue more bonds to pay off the maturing debt. Companies would have to issue bonds at higher interest rates and this eats into profits. Also, issuing more debt to expand operations becomes more expensive, and thus some companies may put a pause on capital expenditures, which is not good for earnings growth.

Consumers are also impacted. As an example, higher mortgage rates lead to fewer home purchases as less people can afford homes. This doesn't help an already weak housing market. When people buy homes, they spend more on appliances and furniture, among other items. These are big ticket items that drive profits in certain sectors. That is why, leading to the financial crisis, the housing market was booming and propelling corporate profits and economic growth along with it.

Midterm Elections

November 3rd is election day in the United States this year. The Democrats are widely expected to retake control of the House of Representatives, and the Senate will likely be more competitive. There will be a lot of noise heading into the election. Markets don't like uncertainty, but the most likely scenario is that we get gridlock in Washington. Neither party will be able to accomplish more aggressive policy aspirations. With less getting done, there should be less uncertainty for investors. There are larger economic forces at play than who controls Congress or the White House. It's prudent to not mix politics and investing. Markets tend to do well regardless of which political party is in power. So, how has the S&P 500 done in the two months prior to past midterm elections? We dug into history, and if you are feeling nervous about the election's impact on your stock portfolio, prior cycles may offer some reassurance.

The S&P 500 has an average return of 2.7% in the 60 days before midterm elections since 1954. Returns were stronger under Republican presidents (+3.6%) and presidents in their second term (+5.1%), though the index fell ahead of the last two midterms.

Figure 2: 60 Days Before Midterm Elections

S&P 500 Performance: Two Months Before Midterm Elections

Year	Election Date	Presidential Party	2nd Term?	Return
1954	Nov 2	Republican		5.0%
1958	Nov 4	Republican	Yes	7.2%
1962	Nov 6	Democratic		0.0%
1966	Nov 8	Democratic		6.2%
1970	Nov 3	Republican		2.6%
1974	Nov 5	Republican	Yes	6.0%
1978	Nov 7	Democratic		-11.0%
1982	Nov 2	Republican		14.3%
1986	Nov 4	Republican	Yes	-3.0%
1990	Nov 6	Republican		-2.8%
1994	Nov 8	Democratic		-1.6%
1998	Nov 3	Democratic	Yes	13.1%
2002	Nov 5	Republican		4.1%
2006	Nov 7	Republican	Yes	6.9%
2010	Nov 2	Democratic		9.5%
2014	Nov 4	Democratic	Yes	0.7%
2018	Nov 6	Republican		-4.3%
2022	Nov 8	Democratic		-4.4%

	Average
All Midterms (Since 1954)	2.7%
Democratic President	1.6%
Republican President	3.6%
1st Term	1.5%
2nd Term	5.1%

Source: Cetera Investment Management, FactSet, S&P Global. Price returns used, which do not include dividends. Investors cannot invest directly in indexes. Do not use this data to make investment decisions.

High Earnings Expectations

S&P 500 earnings growth in the second quarter was a whopping 52.4%, well above expectations for 18% growth prior to the start of the quarter. FactSet Research now estimates earnings growth for the third quarter to be close to 27%. While high expectations are generally good, they can be hard to beat. If companies fail to beat these high bars, we could see a pullback in equity markets.

The good news is that rising earnings estimates have driven down price-to-earnings ratios. The forward 12-month P/E ratio for the S&P 500 is now slightly below its 10-year average. From this perspective, stocks

are no longer expensive. Investing based solely on valuations is generally not a good idea as valuations can remain elevated or depressed for long periods, but for long-term investors, this could potentially provide a good entry point if earnings growth remains strong.

The risks pressuring U.S. equities this quarter aren't isolated to U.S. markets. The same Iran-driven oil shock lifting domestic inflation is hitting global bond and equity markets too. European and UK yields have moved higher alongside U.S. Treasuries, and rising energy costs are squeezing growth prospects for energy-importing economies more than exporters.

Corporate earnings tell a similarly divided story globally with companies tied to the AI buildout are seeing stronger results, while those more sensitive to energy costs and tighter financial conditions are lagging. For U.S. multinationals, that divergence matters directly. A stronger dollar, or weaker overseas demand, can weigh on international revenue this quarter, providing an added wrinkle on top of the domestic risks already outlined.

Equities enter the fourth quarter supported by a resilient underlying economy, but the list of risks is getting longer than usual. Rising bond yields tied to inflation and heavy debt issuance, midterm election noise, and elevated earnings expectations leave little room for error. Global equity markets are facing many of the same pressures, reinforcing rather than offsetting the domestic risks. None of these factors are necessarily bearish on their own. Gridlock in Washington, cooling valuations, and still-solid earnings growth can be supportive, but in combination, could potentially add to market volatility.

Fixed Income

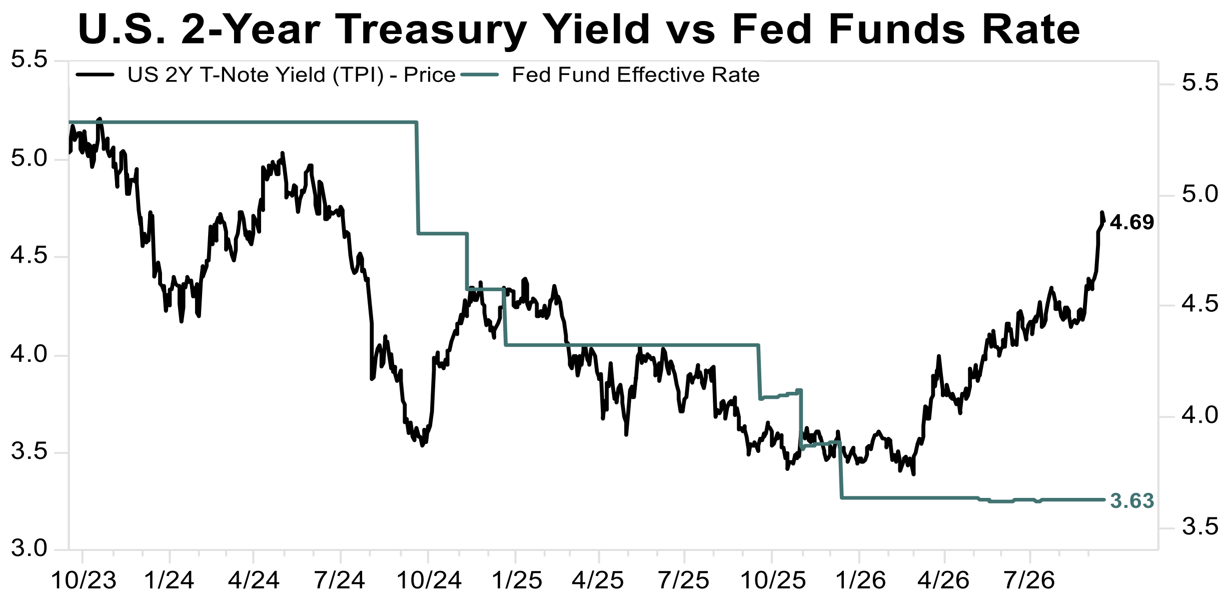
We discussed rising bond yields' impact on both the economy and stocks, but the real question is where yields go from here. That's largely contingent on the war in Iran, which makes it hard to assess. Markets originally discounted the war as short-lived, but it has dragged on, and markets are now adjusting for a longer conflict.

A longer war means higher oil prices, which equates to higher inflation pressures. Bond investors care about returns after inflation, what's often called the "real" return. Longer-maturity yields, like the 10-year Treasury (which mortgage rates are closely tied to), are the most sensitive to the war and to oil disruptions, since they carry more inflation risk over a longer horizon.

Shorter-maturity bonds are tied more directly to the Fed funds rate, and there's plenty of uncertainty there too. The Fed hiked rates for the first time since 2023 in September, taking the fed funds range to 3.75%–4.00%. But the more important signal wasn't the hike itself, it was the gap between what Fed officials are saying and what they're actually projecting. Fed officials have sounded very hawkish in their speeches, suggesting an aggressive pace of further hikes, but their own dot plot tells a more modest story: just one more hike this year, and a hold through 2027 with no further hikes or cuts penciled in.

Bond markets seem to be siding with the hawkish rhetoric over the Fed's own projections. The two-year Treasury yield reflects where bond investors expect the Fed funds rate to land 12 months from now. Right now, that's pricing in roughly three more rate hikes over the next year, well above what the Fed itself is projecting (see **Figure 3**).

Figure 3: More Rate Hikes Expected



Source: Cetera Investment Management, FactSet, U.S. Federal Reserve. Data as of 9/17/2026.

The wild card remains the war in Iran and oil prices, but on the Fed's path specifically, we're leaning toward the Fed's own projections rather than the more hawkish read coming from the dot plot and short-term bond markets. We think the most likely scenario is that the Fed hikes one more time and then holds, as inflation is expected to ease over the next year. However, persistent inflation could lead to additional hikes.

War is a good example of a major uncertainty investors must navigate. The key isn't positioning a portfolio for one specific outcome. It's staying diversified enough to withstand a range of them.

Credit markets have remained stable, even as lower-income consumers struggle to keep up with rising prices. We track this through high yield spreads, which remain historically tight. If bond investors were worried about a recession and rising defaults, that spread would widen and high yield bond prices would fall. If we do see a broader market pullback, we'd expect high yield to pull back with it. The good news is that high yield indexes currently yield around 6.5%–7.0%, which can help offset price losses if that pullback materializes.

Overall, we remain constructive on bonds. Yields have been rising, which has pushed bond prices down but unlike 2022, today's higher starting yields can offset a meaningful share of any further price declines. We could also be near the top of the range for yields, assuming inflation eases next year as expected.

The Bottom Line

The U.S. economy enters the fourth quarter on solid footing, but an unusual number of risks are converging at once. The war in Iran continues to push oil prices and inflation higher, prompting the Fed to pivot from cutting to hiking rates. That shift is adding pressure to bond yields and, by extension, to equities already contending with elevated earnings expectations and midterm election noise. Credit markets, by contrast, remain stable, with tight spreads suggesting investors aren't yet pricing in real distress.

Given how much hinges on how the war evolves, we favor staying diversified over betting on any single outcome. Equities and bonds both have room to perform reasonably well this quarter, but the path is less certain than usual and that argues for balance rather than conviction in one direction.

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