

LAURELHURST ASSET MANAGEMENT

John's Market Outlook – September 29, 2026

In the June Outlook, I said *"The Federal Reserve will not cut rates . . . inflation has become persistent and the new Fed chair sounds hawkish"*. The Federal Reserve raised rates in August and markets expect more rate hikes ahead. With inflation not slowing, we have begun a new rate increase cycle in the US and abroad.^{1/}

The causes of stubborn inflation include labor market disruption^{2/}, tariff impacts on supply chains, the Ukraine war, industry concentration, AI infrastructure construction, and demand for resources such as copper and semiconductors. The Iran war is making things worse; the US-Iran MOU quickly fell apart, Iran and the Houthis resumed attacking Gulf oil exports, and the US has not found a military solution.



Yields broke above 5% for medium-to-long maturity Treasury bonds^{3/}. The US government's interventions failed^{4/} and yield increases accelerated sharply (chart at left). With the Federal Reserve raising rates at the short end, borrowing costs are rising everywhere: mortgages, consumer credit, corporate bonds, and financial markets. The growing Federal debt is both a cause of higher interest rates and made larger by higher rates. Rising rates mean lower bond prices, which harm investors' portfolios and bank balance sheets. Higher rates usually pressure stock valuations, starting with rate-sensitive sectors like utilities and real estate, but eventually reaching equities broadly.

For now, US economic activity remains broadly positive, with employment, industry indicators, higher-income consumer spending still growing as described in my June Outlook. \$1 trillion/yr AI infrastructure spending continues to boost

^{1/} / Market pricing implies expected policy rate hikes in the US, EU, UK, Japan, Canada, Australia, etc.

^{2/} / Examples include truck drivers, discussed in the last Outlook, and other industries with substantial non-citizen participation.

^{3/} / Chart as of September 25, 2026: 10 year at 5.197%, 5 year 5.028%, 2 year 4.886%.

^{4/} / With its borrowing needs, the US Treasury has limited ability to force yields down. The Federal Reserve is unlikely to engage in large-scale yield curve control, given Chair Warsh's stated intent to shrink the Federal Reserve's balance sheet.

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industrial, technology, and resource industries. Consensus S&P 500 estimates have continued rising, which reflects strong margins and growth, and inflation. Growth is not just domestic; revenues and earnings are also growing outside the US.

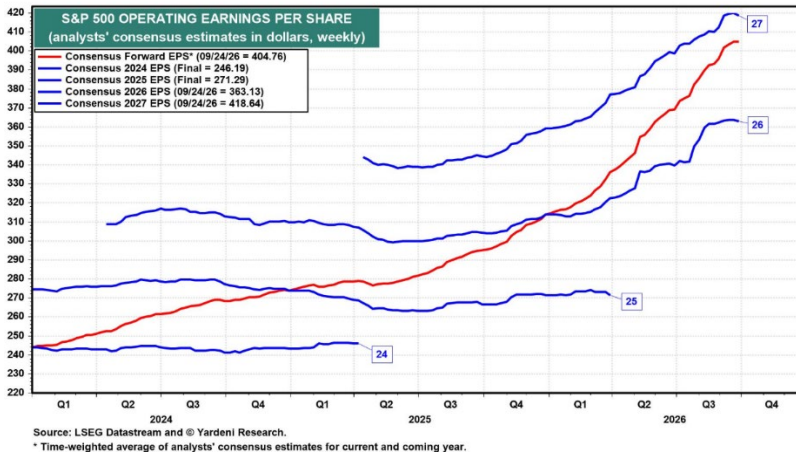
This increasing divergence between worsening inflation/higher rates and improving company sales/earnings is causing me growing discomfort. In June, I said *“portfolios have been less defensive than usual, but I am prepared to shift to more defensive later this year”*. I started that shift this month.

- For some time, I have held fixed income exposure low and maturities very short to reduce interest rate (“duration”) risk. As bond prices fall, yields on longer-maturity bonds will eventually become attractive. Currently, with under one percentage point spread between 2 and 10 year Treasury yields, we are still not being paid enough to take that risk. Within the fixed income allocation, we are positioned to benefit from higher inflation with Vanguard Short-Term Inflation-Protected Securities ETF (VTIP) and higher short term rates with iShares Floating Rate Bond ETF (FLOT) as well as money market funds of zero duration.
- I have cut rate-sensitive sectors like real estate/REITs, building materials, utilities, and some banks. Names exited or reduced include Mid-American Apartment Communities (MAA), Owens-Corning (OC), and Marcus & Millichap (MMI). In a few cases, I added on weakness; an example is Simpson Manufacturing (SSD).
- Portfolios are well exposed to semiconductors like Intel (INTC), AMD (AMD), and Broadcom (AVGO). Growth is very high but so is the risk if AI investment slows. I am trimming semi names on strength to control this risk.
- Portfolios are also well exposed to international equity, such as Siemens AG (SIEGY: German electronics/electrical equipment), PriceSmart (PSMT: Central/Latin America discounter), Mitsubishi Heavy (MHVIY: Japan industrial/defense), Roche Holdings (RHHBY: Swiss pharmaceuticals). Ex-US data is discussed in the Appendix.
- The cybersecurity threat has become acute, with AI models escaping test environments and malicious use of AI growing. Our cybersecurity software holdings, Palo Alto Investors (PANW) and Fortinet (FTNT), have done well. Other software names have been mixed; I have exited some smaller positions.
- The trucking upcycle continues. Spot truckload prices are rising fast and less-than-truckload carriers are taking early rate increases. It takes time to reprice contracted business, so rapid increases in diesel, wage, and insurance costs adds near-term risk. I added on weakness to selected names including Landstar (LSTR) and Saia (SAIA).
- Space Exploration (SPCX) stock is holding roughly at most portfolios’ cost basis and index fund purchases will pick up. The Anthropic and/or Open AI IPOs may be delayed, reducing competition for investor dollars.
- Political risk is rising for the US defense industry with approaching elections and a 2027 Pentagon spending request that looks infeasible. I have reduced names like General Dynamic (GD) and Huntington Ingalls (HII), while leaving exposure to European and Asian defense stocks mostly unchanged.
- Energy stocks recovered as the Iran war resumed. If the US government bans diesel exports, refining stocks may get hit. Gasoline prices will rise⁵/ and force an end to the ban, so I would likely add on such a decline.
- I started a position in Cooper Companies (COO), a leading global maker of contact lenses. Myopia (near-sightedness) is growing globally due to childhood screen time. Largely cash-pay, the contact lens market offers defensiveness and low valuation without exposure to potential cuts in Medicare/Medicaid benefits. When the stock fell on a delay in divesting Cooper’s other businesses, I added to the position.

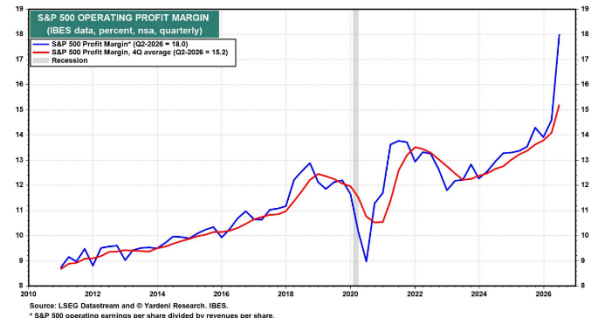
I would be happy to go deeper into this outlook and other investment topics than was possible in this brief summary. Please email johnliu@laurelhurstasset.com or call 510 847 0070. Thank you!

⁵ / Refineries cannot quickly shift the mix of diesel vs gasoline produced from crude, or store un-exported diesel. They will have to reduce crude processed, which will reduce the US gasoline supply, sending gasoline prices up while diesel prices go down.

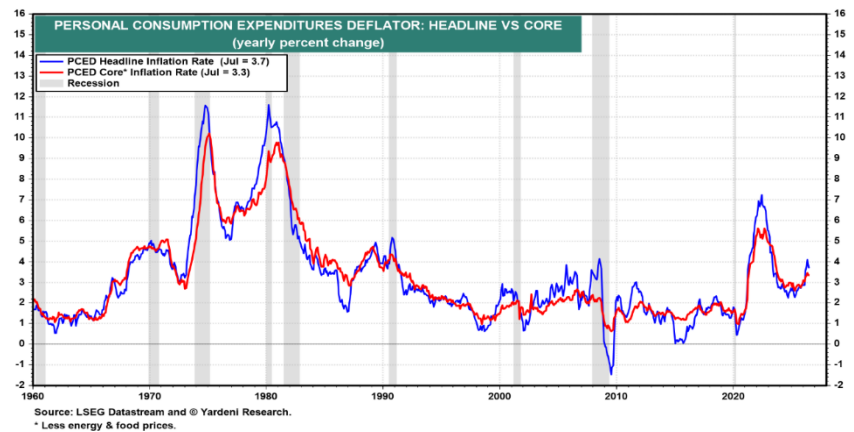
APPENDIX TO SEPTEMBER 2026 OUTLOOK – SELECTED CHARTS AND TABLES



S&P 500 EPS estimates for 2026 and 2027 are still rising (chart to left). S&P 500 margins are very strong (chart below).



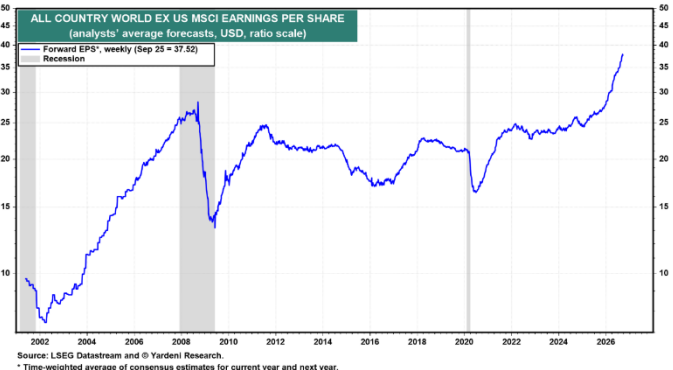
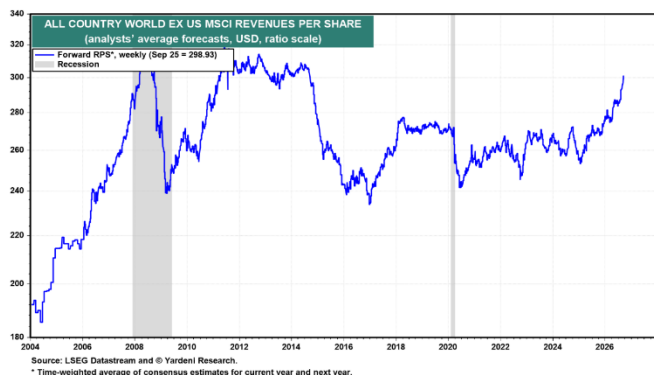
The Federal Reserve committed to using Personal Consumption Expenditures (PCE) as its main inflation metric. Core PCE (3.3%, red line to right) and headline PCE (3.7%, blue line) remain well above the 2% target.



Other US economic data (consumer spending, employment, sales, business surveys, etc) remain broadly similar to the charts I showed in the June 2026 Outlook. In summary, moderate underlying “real” growth plus substantial inflation is producing solid “nominal” growth for the US economy. Weakness in some areas such as real estate, lower/middle-income consumer spending, and some AI-affected employment, has not yet pulled down the broader data or S&P 500 profits.

Rather than repeat those charts, I’ll briefly outline the international situation outside of the US (“ex-US”).

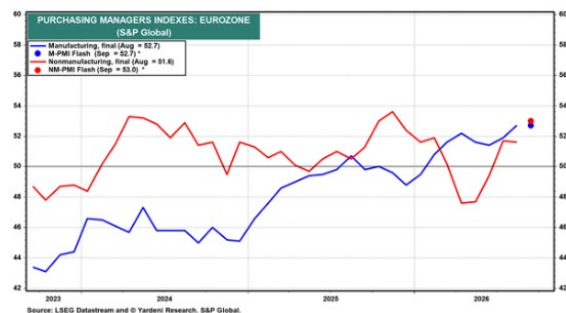
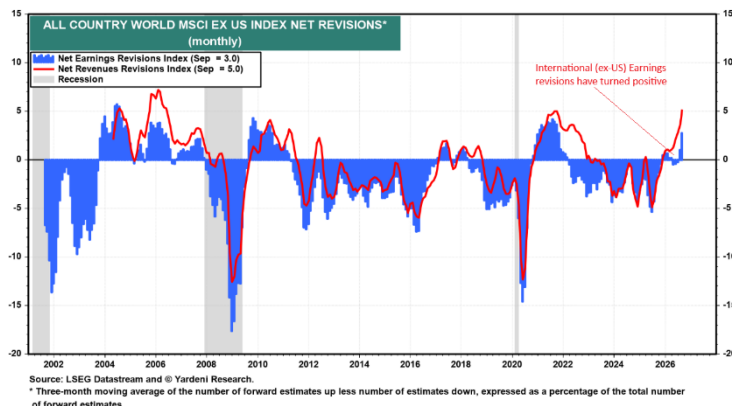
Ex-US, revenues and earnings growth started *accelerating* this year (revenue chart below left, earnings below right).



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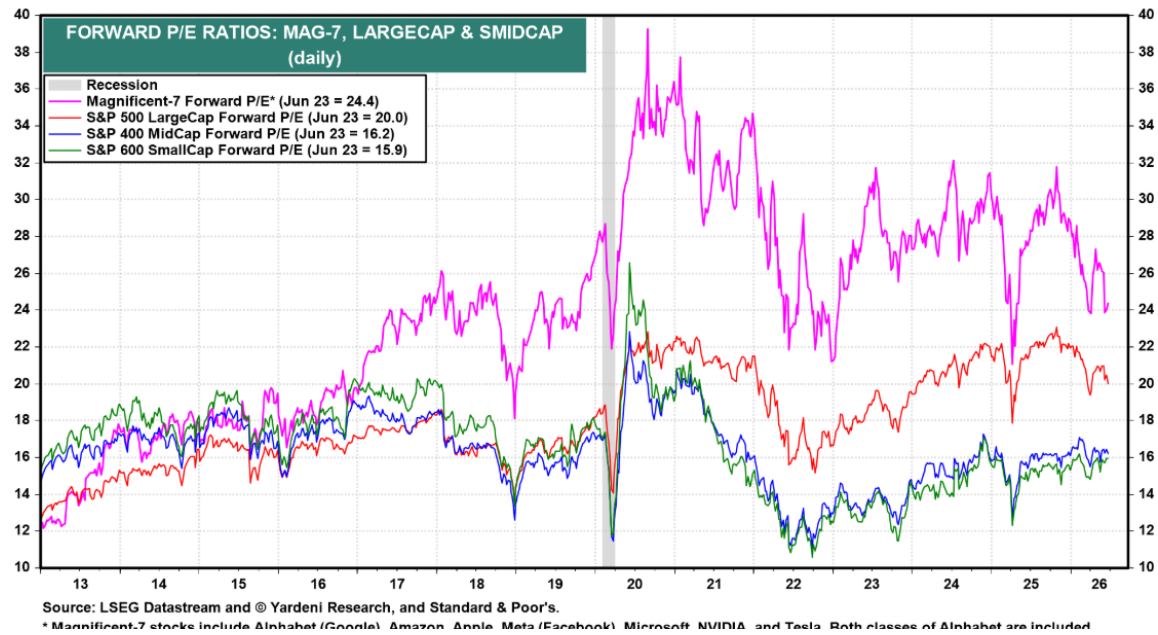
Much of this ex-US growth is in Asia, which supplies the AI infrastructure being built worldwide. Even in the growth-challenged Eurozone, both manufacturing and services indices are above 50, indicating expansion (chart to right).

This acceleration is recent; net ex-US estimate revisions turned positive only this year (chart below left).



Valuations ex-US are undemanding (chart above right), with forward P/E only about 13X. In developed markets (Europe, Japan, etc) the forward P/E is about 15X, similar to the 15X for small and mid-cap US stocks and lower than the 19X for large-cap US stocks.

Finally, the S&P 500's valuation (20X forward P/E) remains high, while mid-cap and small-cap valuations are still reasonable at 16X.



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