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Q3 2026: Outlook Themes (Video)

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As investors enter the fourth quarter of 2026, rising interest rates, corporate profits, and election uncertainty remain key market considerations. In this video, Grimes & Company Chief Market Strategist **Benjamin Wallace** explores the three key themes from our **Q3 2026 Investment Quarterly**, examining how strong earnings have supported stocks, why economic fundamentals matter more than political outcomes, and how higher bond yields are shaping the fixed-income outlook.

READ ABOUT THE Q3 2026 THEMES HERE:

- [9/30/26 Outlook Theme #1: Profits, Oil and Rates Racing Higher](#)
- [9/30/26 Outlook Theme #2: Ride the Election Cycle Without Falling Off](#)

- 9/30/26 Focal Point: Fixed Income's Word Is Its Bond

VIDEO TRANSCRIPT

Hi, I'm Benjamin Wallace, Chief Market Strategist at Grimes & Company. As we enter the fourth quarter, there are three topics we think are especially important for investors: the race between corporate profits and interest rates, what elections actually mean for markets, and why a historically difficult quarter for bonds may have created one of the more attractive fixed-income environments we have seen in years.

Let's start with our first theme: *Profits, Oil and Rates Racing Higher*.

There has certainly been no shortage of headlines this year. Oil prices have risen, interest rates have moved sharply higher, and the 10-year Treasury yield crossed 5%. Normally, when investors hear "higher oil" and "higher interest rates," neither sounds particularly good for stocks.

But there is another side of this story that has been just as important: corporate profits have also been racing higher. And so far, profits have been winning that race.

Oil finished the third quarter around \$90 per barrel, up substantially from earlier in the year. But the futures market is telling a somewhat less alarming story, with the one-year forward price still in the high \$70s.

That difference suggests investors continue to view at least part of the current oil-price increase as temporary. In other words, markets aren't necessarily behaving as though \$90 oil is the new normal.

Oil in the high \$70s can still create inflation pressure, but that is quite different from oil remaining in the \$90s, where it would more seriously threaten economic growth.

That brings us to interest rates.

The 10-year Treasury yield has risen from just under 3.95% in late February to more than 5.25% by the end of September. That is a very large move, but it's important to understand why rates have gone up.

Inflation has played a role, including the impact from oil, but stronger-than-expected economic data has also mattered. In fact, two particularly strong economic reports, unemployment in May and the PMI in the final week of Q3, accounted for a significant portion, about 60 of the 130 basis point rise, of the increase in rates.

That distinction is important. Higher rates because inflation is spiraling out of control would be a much more troubling story, while higher rates partly because investors expect stronger economic growth is more balanced.

Stronger economic growth can put upward pressure on interest rates, but it can also support corporate revenues and profits. And that brings us to the most important part of this theme.

Despite rising interest rates, the stock market has continued to perform well because earnings have been growing even faster. At the end of 2025, the S&P 500 traded at about 22 times expected earnings.

Since then, the market has risen about 14%, which might make you assume stocks have become more expensive. But forward profits have risen roughly 30%, so even though stock prices are higher, the market's price-to-earnings ratio has actually fallen from about 22 to roughly 19.

That is an important point. Stocks have not simply been moving higher because investors are willing to pay increasingly expensive valuations—earnings have been doing much of the work.

Technology has been especially important. The sector has produced very strong returns, but its expected profits have grown even faster, meaning Technology's valuation has actually declined despite its strong performance.

Connecting rising interest rates and rising profits, this next chart shows how the two are racing higher. The earnings yield, which is the inverse of the P-E ratio is compared to the 10yr Treasury yield and the difference, the Earnings Premium, is shown in red.

Despite the rapid rise in rates, the earnings yield has been racing higher as well, keeping the premium just above zero, a sign that interest rates and stock market valuations are holding a tenuous equilibrium.

And, since much of that profit growth continues to be tied to investment in artificial intelligence, AI spending and corporate profit growth remain more important to the stock market than many of the geopolitical headlines competing for investors' attention.

So the question heading into Q4 is fairly straightforward: can profits keep outrunning interest rates? If earnings growth continues, stocks have an important source of support.

If interest rates stabilize or decline, that could relieve some of the valuation pressure we've seen and potentially allow market performance to broaden. The risk would be that rates continue climbing while profit growth begins to slow—and that is the race we are watching.

Our second theme is *Ride the Election Cycle Without Falling Off*. Election season naturally generates a lot of questions from investors, but our basic message is simple: vote at the polls, not with your portfolio.

We say that because when we look at the historical data, political control itself has not been a particularly useful predictor of either stock-market returns or economic growth.

Take a look at this first chart. We examined market returns for the two year periods following elections and compared them with which political party controlled Washington—and even the degree of that control.

The relationship is extremely weak. Democratic control, Republican control, divided government— the dots are scattered throughout the chart, and there simply isn't a meaningful historical relationship between which party controls government and subsequent stock-market returns.

We then ran the same exercise using economic growth, and again, there is essentially no relationship. Political control by itself has historically told us very little about how fast the economy will grow over the following two years.

That doesn't mean policy is irrelevant. Policy certainly can affect individual industries, taxes, regulation, and parts of the

economy, but the economy is much larger than politics.

Credit conditions, innovation, productivity, population growth, interest rates and countless decisions being made by businesses and consumers all matter as well. So if political control doesn't explain market returns particularly well, what does?

Economic growth does a much better job. Here you can see a much clearer relationship in this chart of returns and gdp growth. Periods with stronger GDP growth have generally coincided with stronger stock-market returns, while poor market returns were during periods of weak gdp growth.

That makes intuitive sense. A healthier economy tends to support stronger revenues and stronger corporate profits, and ultimately profits are what give businesses—and stocks—their value.

So rather than asking, "Which party is better for the market?" we think investors are better served asking what is happening to economic growth, inflation and interest rates, and most importantly, corporate profits.

There is, however, one interesting election-related pattern that does show up in the data.

This chart shows the average market performance across the four-year presidential cycle. Historically, year one—the year immediately following a presidential election—has averaged about a 14% return, while year two, the midterm election year, has been the weakest at roughly 4%.

Then year three, immediately following the midterms, has historically strengthened again, averaging about 13%, followed by roughly 6% in year four, the next presidential election year. So the historical pattern is Year 1: 14%, Year 2: 4%, Year 3: 13%, Year 4: 6%.

Why might that happen? One possible explanation is **uncertainty**.

Heading into an election, both sides worry about what could happen if the other side wins, political rhetoric intensifies, and businesses and investors may delay decisions while waiting for greater clarity. Then the election happens, one side is happy with the outcome while the other realizes campaign rhetoric will likely be diluted by the complicated process of becoming actual policy.

As concern and uncertainty fades, markets can then shift their attention back toward the economy, the monetary policy and corporate earnings. Today, we are in year two of that cycle—the historically quieter midterm year.

That does not guarantee that year three will be strong; historical averages are never guarantees. But it provides a useful reminder that election-related uncertainty has happened many times before, and historically markets have eventually returned their attention to the fundamentals.

Our investment process is built around that idea. We do not try to predict election outcomes and trade around them—we measure what is actually happening in markets.

We measure and react rather than trying to predict, and that is how we try to *Ride the Election Cycle Without Falling Off*.

Our final theme is *Fixed Income's Word Is Its Bond*, because in the long run, bonds are the “honest asset class”, because they tell is what they will do: earn their yield to maturity. But they can be liars in the short run due to interest rate volatility. The third quarter was historically bad for bonds, but because of what caused that poor performance, the outlook for bonds today may be the most attractive it has been in many years.

The Bloomberg U.S. Aggregate Bond Index fell about 3.5% during the third quarter. Outside of the historically difficult bond market of 2022, that was the worst three-month period for the index in roughly 25 years.

The reason was the sharp rise in interest rates. Bond prices move inversely to yields, so when market interest rates rise quickly, the prices of existing bonds fall—and that is exactly what happened during Q3.

But there is an important silver lining.

The same increase in rates that hurt bond prices has pushed the yield on the Aggregate Bond Index to roughly 5.6%, its highest level since 2009. And this is why we sometimes describe bonds as the “honest” asset class over the long run.

If you buy an individual bond and hold it until maturity, assuming the issuer does not default, the yield is the return you ultimately receive. Bond funds are somewhat more complicated, but the basic principle still holds: starting yield is a very important driver of longer-term bond returns.

So when interest rates rise, short-term returns can be hurt, but future return potential improves.

This chart helps illustrate just how much the environment has changed. In 2020, bond yields were extremely low while interest-rate sensitivity remained relatively high, so there simply wasn't much income available to cushion investors if rates rose.

Today, that relationship has almost completely reversed. Income is much higher relative to interest-rate risk, and our duration-to-yield measure has fallen to about 1.1, one of its most attractive readings since before the Global Financial Crisis.

In plain English, bonds are now generating much more income to help absorb the short-term price swings that rising rates can create. So we have an interesting contrast.

The third quarter was one of the worst periods for bonds in decades, yet after that decline, the yield available to investors is among the most attractive we have seen in decades. That is why *Fixed Income's Word Is Its Bond*.

Short-term price movements can make bonds look disappointing, but over longer periods, the income matters. And there is one final portfolio point worth making.

If rates remain elevated, bond investors are now being paid considerably more income. If higher rates eventually slow the economy enough that interest rates begin to decline, falling rates would generally benefit bond prices.

That improves the potential for bonds to once again serve as both an income source and a diversifier alongside stocks.

As we enter the fourth quarter, we think these three themes fit together. The relevant race is strong profits helping

stocks withstand rising rates, not the election, as economic growth and corporate earnings have historically mattered far more to markets than political control, while higher rates have created short-term pain in bonds, they have also dramatically improved the income available to bond investors.

Together, they reinforce the importance of maintaining a diversified portfolio and staying focused on the underlying economic and market fundamentals rather than reacting to every headline.

Thank you for watching. As always, if you have questions about these themes, the markets, or how they relate to your portfolio, please reach out to your Grimes & Company advisor. We look forward to speaking with you.

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