IRONWOOD
Investment Counsel, LLC

Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

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Third Quarter 2026 Market Summary

The third quarter of 2026 produced mixed results across financial markets as investors navigated higher interest rates, persistent inflation and increasingly concentrated equity-market leadership. Major U.S. stock indexes remained positive, but performance beneath the surface was considerably weaker. At the same time, a sharp rise in Treasury yields weighed on bond returns and balanced portfolios, even as higher yields created increasingly attractive opportunities for fixed-income investors.

More specifically, the S&P 500 Index gained 2.30% during the quarter. Conversely, the S&P 500 Equal Weighted Index, declined -1.87% over the three-month period. This divergence between the major U.S. indexes illustrates the continued influence of mega-cap technology and artificial intelligence-related companies on the S&P 500 Index performance.

Small capitalization companies also experienced a challenging quarter. The Russell 2000 Index fell by more than -7% during the three-month period. The sharp quarterly decline in the small-cap index highlights the more challenging environment faced by smaller companies, which can be particularly sensitive to higher borrowing costs and economic uncertainty.

International equities, as measured by the MSCI EAFE Index, were flat during the quarter but are still up nearly 10% for the year. International equities have continued to be a strong performer over the last two years. The dollar remained comparatively stable over the period. The Bloomberg U.S. Dollar Index declined slightly, falling -0.22% during the quarter, although it remained up 1.33% for the year.

Fixed income experienced a more difficult period. The Bloomberg U.S. Aggregate Bond Index declined by -3.51% during the quarter and was down -2.91% on a year to date basis through September 30th. Because bond prices move inversely to interest rates, the decline serves as a reminder that even conservative investments can experience price volatility. Going forward, the yields across bond investments offer extremely compelling returns relative to the last two decades.

Market Concentration and Valuations

Equity market concentration continues to be a theme of this year's results and became particularly apparent in September as the quarter came to an end. Nearly 80% of stocks declined during the month, with the average stock falling approximately 5%. Only two of the 11 market sectors produced positive returns: Technology and Communication Services. Communication Services benefited considerably from the performance of Meta and Alphabet, which are classified within that sector rather than Technology.

Much of the stock market leadership remains connected to artificial intelligence and the enormous infrastructure investment taking place around it. Investors continue to reward companies involved in semiconductors, cloud computing, data centers and other parts of the AI ecosystem, while many companies outside that theme have experienced weaker performance.

Periods of narrow market leadership can be risky, and they reinforce the value of diversification and disciplined valuation analysis. Strong recent performance does not necessarily mean an investment offers attractive prospective returns, particularly when high expectations are already reflected in its price.

Inflation Remains a Concern

Inflation remained above the Federal Reserve's long-term objective during the quarter. The Consumer Price Index increased 3.5% year over year in June, 3.4% in both July and August, and 3.7% in September.

Energy prices have become an increasingly important part of the inflation story. Oil prices rose sharply during the quarter, with West Texas Intermediate crude gaining 46.33% and more than doubling year to date through September. Such a dramatic rise in oil prices is significant because energy costs can affect consumer spending and corporate profit margins across a wide range of industries.

Meanwhile, diesel prices have risen approximately 60% since the beginning of the year and recently reached record levels (as of the time of this writing). These rising diesel costs can have broader implications throughout the economy, as diesel powers much of the equipment and transportation used in agriculture, manufacturing and shipping, which can affect the cost of food, materials and other consumer products.

The persistence of inflation remains particularly important because it impacts policy maker's decisions. Even when underlying economic growth appears relatively stable, policymakers remain attentive to the possibility that inflation could remain above desired levels for longer than anticipated.

Federal Reserve Policy and Higher Interest Rates

The Federal Reserve raised the federal funds target range by 0.25% during the quarter, from 3.50-3.75% to 3.75-4.00%. Over the course of the quarter, the yield on the 10-year U.S. Treasury increased 0.83%. According to FactSet, this marked the largest quarterly increase since 1994. The corresponding decline in bond prices helps explain much of the negative return for bonds during the quarter, as well as the more muted performance of balanced portfolios.

Higher yields have different implications depending on whether someone is borrowing or investing. For borrowers, the impact is increasingly restrictive. For instance, thirty-year mortgage rates have moved above 7%, placing additional pressure on an already challenging housing market. Higher financing costs also affect businesses and consumers throughout the broader economy.

For fixed-income investors, however, the story is more encouraging. While rising yields cause the prices of existing bonds to decline temporarily over the short term, those higher yields create better prospective income opportunities going forward. Municipal bonds and treasuries are areas where we believe opportunities have become particularly attractive.

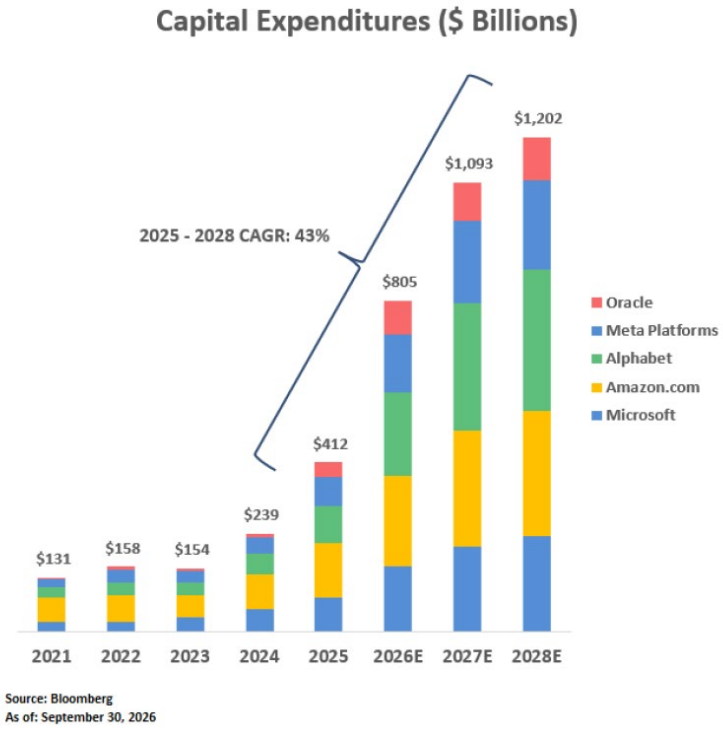
AI Investment Continues to Accelerate — But at What Cost?

AI remains one of the most significant investment themes in financial markets. Last quarter, we discussed the extraordinary capital expenditures being made by companies building the infrastructure required to support AI. That investment continues to accelerate.

Alphabet, Amazon, Meta, Microsoft and Oracle are collectively expected to spend trillions of dollars on AI-related infrastructure through the end of the decade. Bain Capital estimates hyperscaler capital expenditures could reach approximately $780 billion in 2026 alone, nearly five times the level of just three years ago. These shocking estimates raise an important question — will the profits ultimately generated justify the significant amount of capital being committed today?

Another significant development is beginning to change the financial profile of the AI investment cycle. Many of the large technology companies leading the AI buildout have historically generated extraordinary amounts of cash, allowing them to finance investments primarily from their own operations. Increasingly, however, the amount of spending required is causing companies to turn to the debt markets and other financing arrangements.

Debt issuance among six major hyperscalers — Alphabet, Amazon, Meta, Oracle, Microsoft and SpaceX — is expected to reach approximately $244 billion in 2026, up from $109 billion in 2025, according to The Wall Street Journal. Furthermore, research from Ares highlights how AI-related financing has expanded across corporate bonds, leases, private credit, asset-backed securities and other forms of borrowing. Although these obligations may appear diversified, many ultimately depend on the financial health and continued investment of the same relatively small group of companies.



The AI ecosystem itself has also become increasingly interconnected. Technology companies are investing in AI developers, providing them with computing capacity and financing infrastructure that uses products purchased from other companies within the same ecosystem. This raises concerns, as many AI-related investments that appear independent may share common underlying risks.

One of the most important distinctions for investors is the difference between technological innovation and investment returns. History contains many examples of transformative technologies that ultimately exceeded even the most optimistic expectations, yet investors who paid excessively high prices for companies associated with those technologies did not always earn attractive returns. When evaluating today's AI-related companies, it is essential to understand what assumptions about future growth, profitability and investment returns are already embedded in their valuations.

Labor Markets and Consumer Conditions

The labor market continued to produce mixed signals during the third quarter. Nonfarm payroll gains were revised to 31,000 in June (from 57,000) and 21,000 in July (from -23,000) before improving to 162,000 in August. While hiring has slowed considerably from the stronger pace seen earlier in the economic cycle, unemployment has remained relatively low. Data continues to suggest moderation in labor demand rather than a sudden contraction.

Consumer confidence, however, weakened notably. The Conference Board's Consumer Confidence Index declined from 90.2 in July to 88.6 in August and 81.9 in September, its lowest level since 2014. At the same time, retail sales (excluding autos) remained relatively resilient, increasing 5.9% in June, 5.1% in July and 6.2% in August. This disconnect is noteworthy. Consumers are expressing greater concern about the economy even as spending remains relatively strong.

Concluding Thoughts

The third quarter illustrated why looking beneath headline market returns remains important. Major equity indexes continued to advance, yet much of the broader market struggled. Rising interest rates hurt bond prices in the short term but simultaneously created some of the most attractive prospective fixed-income opportunities we have seen in years.

And while AI continues to create incredible possibilities, the amount of capital and increasingly complex financing required to support its development deserves careful consideration. It may prove revolutionary, but the ultimate investment outcome will depend on whether future earnings and cash flows justify today's valuations.

At Ironwood Investment Counsel, we believe this environment reinforces the importance of focusing on fundamentals rather than following market momentum. There will always be factors investors cannot control — interest rates, inflation, market sentiment, geopolitical events and technological change among them. What we can control is the quality of the investments we make, the prices we pay for them, and the diversification within portfolios.

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