The Legacy Group, Inc.

Dear Legacy Clients,

Thank you for your continued partnership and trust, and welcome to our quarterly economic and investment update. In this letter, we will be detailing our thoughts on the current investment landscape, reflecting on the third quarter of 2026, and providing our general economic/investment outlook going forward.

Stocks delivered a mixed bag of returns during the third quarter, trading mostly sideways as continued geopolitical uncertainty and a more “hawkish” Federal Reserve pushed interest rates higher. To reiterate from last quarter, the primary consequence of the war between the United States and Iran has been drastically higher prices for crude oil and natural gas, as Iran has closed off access to the Strait of Hormuz in an attempt to leverage its global economic impact. Very high energy prices tend to weigh on stock prices because they are often associated with higher risks of both economic slowdown and inflationary pressures. When the war began, oil spiked from the mid-$60s to around $110 per barrel, peaking in April. Last quarter, we reported oil at roughly $70 to $75 per barrel, and this quarter it moved notably higher, hovering close to $90 per barrel as of October 1st. As of October 8th, the war remains in a stalemate. President Trump has stated that he does not plan to attack Iran between now and the midterm elections, while simultaneously sending a third aircraft carrier to the region. In the short term, oil exports through the Strait of Hormuz have increased, though they require the assistance of U.S. military escorts. Saudi and UAE pipelines are also being used to bypass the Strait entirely, but these are vulnerable to attack as well. There has, however, been some hopeful news. After threatening to ban U.S. oil exports, which G7 nations have relied on since the war began, President Trump convinced the G7 to tap into its strategic oil reserves. The hope is that this will increase supply and put downward pressure on oil prices in the short term.

Turning now to inflation, price pressures continue to remain higher for longer due to the elevated fuel prices that have persisted since the conflict began. Higher fuel prices matter not only because of the cost of fuel itself, but also because fuel feeds into inflation across nearly every other part of the economy, as companies facing higher fuel costs may raise the prices of their products to offset them. The Federal Reserve's preferred measure of inflation is the Personal Consumption Expenditures (PCE) Price Index, for which it maintains a long-run target of 2%. As of August, headline PCE inflation measured 3.4% year-over-year. As we discussed last quarter, Core PCE excludes volatile food and energy prices and is generally viewed as a better indicator of longer-term inflation trends. As of August, Core PCE measured 3.0%. Both figures came in lighter than expected and are lower than what we reported last quarter (4.1% headline, 3.4% core), but both remain above the Fed's 2% target. Similarly to last quarter, this PCE report also showed higher-than-expected consumer spending in the face of high energy prices, which suggests that fuel prices may be stubborn to retreat from here, since economically speaking, they have little reason to. We reiterate, however, that average hourly earnings are not outpacing inflation, as shown in the September employment report. We and others believe this should help buffer against a rapid increase in Core PCE and ensure that core inflation does not experience intense upward pressure. Over time, we still expect inflation to cool, as wage growth continues its slow and steady decline and housing inflation, which operates on a lag, continues to work its way lower. That said, we believe it is safe to say that the timeline for this has been pushed out.

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The recent increase in inflation is particularly relevant because of its implications for Federal Reserve policy. As a reminder, the Federal Reserve (the "Fed") is tasked with a dual mandate from Congress: stable prices and maximum employment. To combat inflation, the Fed raises interest rates in an effort to slow economic activity. Conversely, when labor market conditions weaken, it lowers interest rates to support economic growth and employment. Interest rate policy matters for the stock market since lower rates are generally supportive of stock prices. Last quarter, we noted that new Fed Chair Kevin Warsh signaled a willingness to raise rates when he emphasized his commitment to delivering price stability. True to his word, at the Fed's most recent meeting in September, Chair Warsh and the rest of the Federal Open Market Committee raised the federal funds rate by 0.25%, the first rate hike since 2023. This marks the beginning of this Fed's "rate hike cycle," or the period during which the Fed raises rates periodically. To reiterate from last quarter, the "slowing labor market" rationale for cutting rates that was in place earlier this year is no longer in play, as labor market growth over the past two months has been relatively decent. August's employment report showed more jobs added than expected and September's showed fewer, but the point is that the economy is still chugging along. At the September press conference, Chair Warsh stated outright that the labor market is essentially at full employment and is strong enough to withstand rate hikes over the medium term. A hawkish Fed (aka one focused on stopping inflation) can be problematic for stocks, as it was in 2022. In our view, however, that year's market sell-off was due to the magnitude and frequency of the rate hikes that took place at that time, which included multiple back-to-back hikes of 0.75%. As we said last quarter, we expect this hiking cycle to be slower and more gradual, and therefore less harmful to asset markets.

From an asset class perspective, the biggest driver of stock market performance this quarter was rising interest rates. Specifically, the 10-year Treasury yield recently broke above its post-Covid high of around 5%, reaching about 5.3% as of October 1st. U.S. large cap stocks delivered modest returns of about 2% on the quarter, with the bulk of the upside coming during a rally in the first week of August, followed by mostly sideways (or "range-bound") performance for the rest of the quarter. Small cap stocks were down roughly -7.5% on the quarter, as rising rates generally tend to hurt small caps more. Small caps are still up 14% on the year. Going forward, we continue to expect strong domestic equity performance driven by the ongoing AI infrastructure build-out. JPMorgan's quarterly global equity allocation research now projects 27% U.S. profit growth this year and 22% in 2027. To put that into perspective, back in January they were expecting just 14% U.S. profit growth for this year. International stocks were flat to slightly negative on the quarter due to headwinds from the ongoing conflict in the Middle East. As we have said in our previous two letters, many foreign economies are more dependent on imported energy than the U.S., which ties their stock markets more closely to the conflict while oil prices remain significantly higher than pre-war levels. International stocks were outperforming U.S. stocks at the beginning of the year before the war started, and we expect any resolution to this conflict, whenever that may be, to coincide with a return to international outperformance. Bonds declined notably during the quarter as interest rates rose, with the Bloomberg U.S. Aggregate Bond Index posting a total return of nearly -3% so far this year. Gold rallied modestly during the quarter but is still down roughly -3.5% on the year as of October 1st. As we mentioned last quarter, rising short-term rates generally tend to be good for the U.S. dollar, which is usually inversely correlated with gold. In spite of this, State Street Investment Management's monthly "Chart Pack" research points out that over the past six Fed rate hike cycles going back to 1994, gold has actually rallied or remained relatively flat during each one, with the exception of 2022. Going forward, we remain confident in the asset class.

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Turning now to our recession outlook, the economy is still growing and appears healthy by virtually all measures. Third quarter GDP is currently forecasted at a very strong annualized rate of 3.7%, well above the long-term trend of approximately 2%, and consumer spending played a big part in this number. Consumption has remained strong in spite of higher energy prices, and we reiterate our point from last quarter that American consumers now allocate far less of their total purchasing power to energy goods and services than at almost any point in history. Regarding the near-term outlook, Franklin Templeton's quarterly "Anatomy of a Recession" research expects consumption to remain resilient throughout the remainder of the year, as households are reporting a lower likelihood of missing minimum debt payments. As 10-year Treasury yields break out to new post-Covid highs due to Federal Reserve rate hikes and ongoing fiscal spending, concerns have naturally risen that these higher rates could hurt the economy and stock market. However, Nick Colas of DataTrek Research makes the crucial point that 10-year yields are also rising for positive economic reasons. More specifically, he refers to the fact that our consumer-driven economy has not slowed down meaningfully despite oil prices being so high. Historically speaking, similar oil price shocks have caused the U.S. economy to either slow meaningfully or enter a recession, as higher oil prices caused consumers to stop spending. As a result, 10-year yields plummeted as investors bought bonds for safety. Today, we are seeing the opposite effect, because a strong, recession-resistant economy implies that interest rates adjusted for inflation (aka "real interest rates") should be higher. The bottom line is that we do not believe higher 10-year yields are to be feared in terms of their impact on the economy. As for the labor market, as we mentioned earlier, the economy is still steadily adding jobs, and the labor market appears to be in good shape. Job openings are still modestly available relative to job seekers, and any potential pickup in layoffs seems unlikely given that weekly claims for unemployment insurance remain low. The unemployment rate ticked up from 4.2% to 4.3% in the September employment report, but this increase occurred primarily due to new job seekers entering the workforce rather than layoffs. For now, we anticipate a continuation of the "low-hire-low-fire" labor market.

Regarding portfolio positioning, we are once again not making any changes to our target asset allocation this quarter. While the possibility of additional Federal Reserve rate hikes has increased due to persistently elevated inflation, we reiterate that today's inflation environment remains materially different than the one experienced during 2022. Ultimately, we believe the macro environment remains constructive, as corporate earnings continue to exceed expectations while the broader economy demonstrates resilience in the face of geopolitical uncertainty. We hope that you find these updates helpful, and please do not hesitate to reach out if you have any questions.

Sincerely,



Austin Smith, Analyst for The Legacy Group, Inc.

Craig Lestner, CFP® President

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DataTrek Research: DataTrek Morning Briefing

- September 16, 2026: “Fed Chair Presser, New Hike Odds, Economic Google Trends”
- September 20, 2026: “Treasuries & Oil, Q3 Equity Returns, Quarterly Call AI Mentions”

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