

**MARCH 2026**

QUARTERLY INVESTOR LETTER

Market divergences and reversals, which characterize this year's performance, continued through the Third Quarter. Index-level volatility remained low and stable while single stock volatility surged. This divergence has reached the widest point since 2000, prompting debate as to whether the development signaled future market weakness. Picture a duck floating around a pond. Above the water's surface (i.e., index-level), there is calm. Beneath the surface (i.e., single stock level), there is furious activity. Investors disagree on whether we should focus above the surface or below.

Some market observers interpret volatility divergence as the benign impact of industry/sector rotation. Gains in one sector are offset by losses in another as investors rebalance, but the overall effect on the market is neutral. Other commentators believe the divergence reflects the combination of rising single stock volatility, which suggests growing investor anxiety about future earnings, and structural elements that artificially suppress index-level volatility.

As an isolated indicator, volatility divergence offers limited information value. Its significance would increase if supported by other indicators. For example, the average stock fell during the quarter, and valuation multiples contracted. This fact supports concerns signaled by rising single stock volatility. At the same time, earnings growth exceeded expectations, which aligns with the optimism associated with low index-level volatility. The stock market continued to alternate in short-term intervals between low and high participation, otherwise known as "breadth." These rapid shifts contribute to single stock volatility but do not necessarily suggest an imminent correction. Combined, however, these factors confirm rising uncertainty

regarding future market direction.

More important, the Third Quarter witnessed a substantial increase in the overall cost of capital, which hinders economic activity and reduces the valuation of financial assets. The Fed cited persistent inflation as the principal reason for increasing policy rates at its late August meeting. The unresolved Iran Conflict, with its concomitant impact on commodity-push inflation, has contributed to inflationary pressures. Those concerns manifested in rising yields on intermediate and long-term Treasuries.

Current yield levels are near or above twenty-year highs. Since 30-year mortgage rates are pegged to the 10-year Treasury, recent bond market performance has incrementally boosted the cost of financing for the housing sector. However, rising bond yields are also consistent with economic data that indicate a strong economy with low unemployment. This view suggests "real" interest rates (i.e., nominal yields less inflation) have risen high enough to attract investors to the bond market.

Therefore, the outlook for the markets is mixed as the final quarter commences. There are enough negative signals to warrant caution. Those signals are offset to a certain degree by powerful stimulative forces, including massive capital expenditures associated with the AI build-out. Consequently, projections of AI supply and demand will increase in prominence as a factor in economic and market outlooks. On balance, we recommend maintaining long-term strategic allocations while remaining vigilant against the market's pattern of short-term course corrections.

Please contact the office if you would like to schedule a review meeting, either in person or by Zoom.