ALTA
CAPITAL MANAGEMENT
A member of Guardian Capital Group Limited

MARKET LETTER

October 2026

The U.S. equity market extended its advance in the third quarter with the S&P 500 returning 2.3%, bringing its year-to-date return to 12.7%. Businesses benefiting from the Artificial Intelligence (AI) buildout continued to drive strong growth in corporate earnings, while rising interest rates weighed on valuations and sentiment. Beneath headline numbers that were largely stable, dynamics at the stock level were anything but, with large drawdowns in higher risk and momentum areas of the market stemming from a unique combination of excessive leverage, rising interest rates, and a maturing business cycle. Despite a quarter end close less than 2% below the S&P 500's all-time highs, 43% of constituents were at least 20% off their 52-week highs. After a macroeconomic environment with an early cycle feel drove a risk-on, low-quality rally for the better part of 2026, the latest shift has reinforced Alta's longstanding philosophy of owning high-quality businesses with pricing power and strong free cash flow generation.

Exceptional growth paired with a broad rise in interest rates defined much of the third quarter. The 10-year Treasury yield climbed from 4.44% to 5.29%, an increase of 85 basis points (bps), closing above 5% and ending the quarter at its highest level since 2002. While much of the move was induced by energy-driven inflation, we believe accelerating growth may also be a material factor. The war with Iran, now in its seventh month, has disrupted shipping through the Strait of Hormuz, pushing oil prices to new highs and lifting gasoline prices more than 27% from a year ago. This is one factor behind the move higher in the Consumer Price Index (CPI), which rose 3.4% over the twelve months ending in August, outpacing the Fed's 2.0% target. Despite persistent inflation and rising energy costs, second quarter real Gross Domestic Product (GDP) growth was revised up to 2.2%, August payrolls rose by 162,000 against a forecast of 60,000, unemployment held at 4.1%, and retail sales jumped 1.2% versus the prior month. The strong economy and rising inflation prompted a hike from the Federal Reserve (Fed) in September for the first time since 2023. The market largely anticipated this with rates rising consistently across the yield curve both in the U.S. and globally, lifting mortgage, auto, and corporate borrowing costs and driving investor unease. Ahead of the November midterm elections we expect the market may remain choppy, but given the broad economic strength, higher rates and energy costs may act more as a governor for growth than a brake.

Against this backdrop, the artificial intelligence build-out continues to accelerate, and it remains a significant force in both the economy and the equity market. The largest cloud providers now plan to spend nearly $750 billion on capital investment in 2026 alone, propelling technology investment to over half of all capital investment within the U.S. economy. The halo effect of this spending is showing up in corporate profits. According to FactSet, S&P 500 earnings are expected to grow 29% in the third quarter, which would mark the third consecutive quarter of growth above 25%. While technology-related companies account for much of that growth, the median company in the Russell 3000 grew earnings per share over 14%, the strongest rate in nearly five years. Even after a strong run, the S&P 500 trades at about 19x forward earnings, in line with its ten-year average, because profits have outgrown stock prices by a wide margin in 2026. We believe the productivity benefits of AI are in their early innings and could broaden beyond the semiconductor and infrastructure suppliers to the businesses that deploy these tools well. A build-out of this scale may not proceed in a straight line, however, and we remain selective about where and how we participate.

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The S&P 500 is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap universe. The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The Personal Consumption Expenditures (PCE) price index measures the prices paid by U.S. consumers for goods and services; the core measure excludes food and energy. Gross Domestic Product (GDP) is the total market value of all finished goods and services produced within a country's borders in a specific time period. The federal funds rate is the interest rate at which depository institutions lend reserve balances to one another overnight, set as a target range by the Federal Reserve. A basis point (bp) is one one-hundredth of one percent (0.01%). Free cash flow is operating cash flow less capital expenditures. The forward price-to-earnings (P/E) ratio is a price divided by estimated earnings over the next twelve months.

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