Atlantic Retirement & Wealth Advisors LLC
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The Overshoot Trap: Why Market Interest Rates and Prices Go Too Far

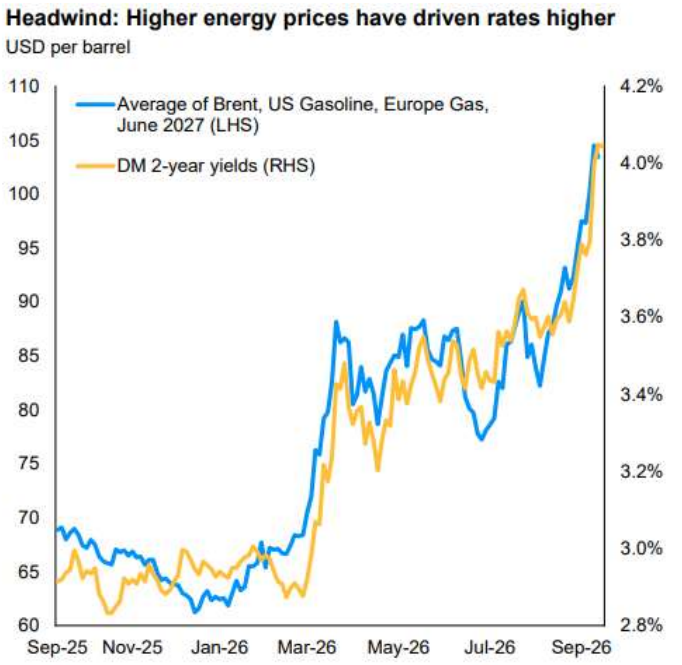
The third quarter saw some of the most violent interest rate moves in decades. At the beginning of 2026 the markets were pricing in three rates cuts. Today, they are pricing in over four interest rate hikes. The third quarter Treasury rise in rates was the sharpest since 1994. Yields have now climbed to levels last seen in 2022 and are above the peak reached in 2007. Why the change and will the Federal Reserve really hike that many times?

Market traders are stating the rate hikes are driven by:

- The longevity of the Iran war and the increase in oil, diesel and gas
- Tariffs are no longer being absorbed by firms and they are passing along price increases
- The size of the AI build-out is causing a cash shortage as debt offerings are skyrocketing
- Global government debt levels are at historic highs and rising fiscal deficits are requiring additional bond offerings

However, some of the typical reasons for higher rates have not been present:

- Mortgage applications are at all-time lows due to elevated prices and rates
- Employee productivity statistics are running very high, doing much more with less
- Company and individual default rates are very low compared to historic levels
- Auto loan originations are six percent lower in the first half of 2026 than in 2025
- Wage increases have moderated versus prior years



Source: Bloomberg, J.P. Morgan Asset Management, FactSet, company disclosures. LHS as of Sept

When looking at the above chart, you can see that we have compared the average Brent oil/gas price (left side) with the 2-year developed market interest rate yield (right side). There is no doubt that short term rates are mirroring commodity prices, in particular oil. This is clearly a momentum trade that could be halted or reversed quickly depending on what happens in the Middle-East. Underlying core inflation, such as rents and other goods, have been moderating over the last couple of years. Currently core inflation is around 2.5%-3.0%. In our view, it would be a significant policy

mistake should the Federal Reserve raise rates four times. If that happens, we believe an economic recession would be likely; at least in the housing, auto and consumer rate sensitive areas of the economy. We would also find it hard to believe these areas would not spill over into the broader economy.

So how much can interest rates rise? Clearly markets and traders do not know exactly. Many elements, such as the Middle-East, Russia/Ukraine and tariffs, are out of their control. When markets are uncertain, they typically overshoot with worry and thus price in the worse-case scenarios, which is what we believe is happening now in the fixed income / bond area. We do think we could see one or two more hikes, but unless we have an all-out war in the Middle-East, or other extreme geo-political issues, we don't see four in the offering. In this environment we are focusing on long term opportunities at attractive yields.

Equity Markets

The third quarter stock markets showed additional underlying volatility, some caused by the bond market. Smaller companies typically have more debt; thus, higher rates will increase their costs and lower their profit. Most of the S&P 500 index stocks (62%) were lower in the third quarter. However, because of the significant concentration and valuations of a few firms (META / Facebook) the large cap index did not adjust as much as the other equity indexes. Large cap companies' earnings and margins continue to be solid, which is stabilizing the market. Higher interest rates have yet to show in their financial statements. The markets are starting to adjust future earnings within the small and mid-capitalization stocks, and because of this, these indexes are negative during the third quarter. Other areas that struggled with higher interest rates in the third quarter include the financial, insurance, utilities and real estate industries.

International and emerging markets stocks started strong in the quarter but showed significant pressure in September due to higher interest rates in Japan as well as across the globe. Many European and Asian countries import the majority of their commodities, thus experiencing higher inflation given the Middle-East tensions. Should commodity prices stabilize, some of the emerging market economies are well positioned.

Given current market valuations and earnings momentum we still see opportunity in the equity markets.

Bond Markets

With the increase in inflation expectations and thus interest rates, the fixed income returns struggled during the third quarter. Some bond sectors experienced double digit losses. The move in prices and yields was more extreme in the short end of the curve, specifically 2-year duration. The municipal sector (states, towns, water etc.) saw significant swings in prices and yields as issuance is up in 2026 and tax collections became a worry. With after tax yields approaching 7%-9% we are starting to see opportunities to lock in future returns.

Overall Landscape

We continue to focus on long-term results, client outcomes and objectives. These are never static given all the variables included in our analysis as well as our clients' life changes. We continue to prioritize diversification, risk management and capitalizing on opportunities in this market.

Index Returns

Index – US Equities	Q3 2026	YTD 2026
Dow Jones Average (TR)	-2.34%	7.19%
S&P 500 (Price)	2.03%	11.77%
S&P 500 (TR)	2.30%	12.75%
Morningstar US Mid Cap Core (TR)	-2.91%	12.06%
Morningstar US Small Cap Core (TR)	-5.06%	4.80%
Morningstar US Large Cap (TR)	3.36%	12.16%
Morningstar Large Cap Value	2.29%	9.95%
Morningstar Small Cap Value	-3.23%	10.22%
S&P Small Cap 600 TR	-7.93%	14.08%

Index - International	Q3 2026	YTD 2026
MSCI ACWI All cap NR	1.08%	12.95%
MSCI Emerging Markets GR	-.24%	23.73%
MSCI EAFE	.81%	10.33%

Index – Fixed Income	Q3 2026	YTD 2026
Bloomberg US Bond Aggregate (TR)	-3.51%	-2.91%
Bloomberg US Corporate A Inter (TR)	-2.33%	-1.73%
BBGBARC Muni Inter-short 1-10 (TR)	-3.71%	-2.67%
Bloomberg High Yield Muni (TR)	-5.55%	-1.68%
BBGBARC Muni 10 Yr 8-12 TR US	-6.07%	-5.04%

S&P Target Risk Models	Q3 2026	YTD 2026
S&P Target Risk Conservative (PR)	-2.64%	.15%
S&P Target Risk Moderate (PR)	-2.13%	1.79%
S&P Target Growth Aggregate (PR)	-1.12%	5.09%
S&P Target Risk Aggressive (PR)	-.13%	8.42%

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