WestStar
Wealth Management

WEALTH WATCH

2026 Third Quarter Review
& Fourth Quarter Outlook

Few literary works capture the psychological strain of uncertainty quite like Edgar Allan Poe's The Pit and the Pendulum. Written in 1842, the story follows an unnamed prisoner confronted by two distinct dangers. Below him lies a dark pit representing sudden catastrophe and destruction; above him swings a razor-sharp pendulum, slowly but relentlessly advancing toward its target. The true terror of the tale is not necessarily either threat in isolation, but rather the uncertainty of which may strike first. Likewise, economic uncertainties currently abound.

The Pit & the Pendulum

Investors may feel a similar sense of foreboding unease as we enter the final quarter of 2026. Concerns regarding inflation, rising energy prices, geopolitical conflict, and elevated interest rates continue to threaten the market's potential descent into the proverbial pit. Simultaneously, the political pendulum appears poised to swing once again, with current polling and historical precedent suggesting a possible shift in congressional power following November's mid-term elections.

In the spirit of Edgar Allen Poe's classic tale of terror, we will examine both the potential pecuniary pit and political pendulum, assess the risks facing the economy and markets, and determine whether recent fears represent an existential threat or simply another obstacle to be navigated on the path toward long-term investment success.

What You Need To Know:

- Stocks maintained their resilience amid persistent geopolitical and economic dangers
- International, Small Cap, and Value-style stocks continued to outperform, while rising interest rates pressured bonds
- The Iran War and aggravating Middle East tensions have kept oil prices elevated
- Oil transport costs currently outweigh supply in importance, and limited additional refining capacity remains a threat
- Post-election market rallies are typical, yet rising rates and Fed action may dampen prospects
- Adherence to long-term strategy remains the most effective means to achieving long-term goals



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Asset Class Index Performance* Year-to-Date As of September 30, 2026

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Commodities
32.87%

International Emerging Market Stocks
23.38%

US Small Cap Stocks
13.71%

US Large Cap Stocks
12.75%

International Developed Market Stocks
10.33%

Alternative Investments
3.77%

Real Estate (REITs)
3.74%

Money Market (Cash)
2.65%

High Yield Bonds
0.10%

International Bonds
-2.52%

US Investment-Grade Bonds
-2.91%

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Market Recap & Tactical Positioning

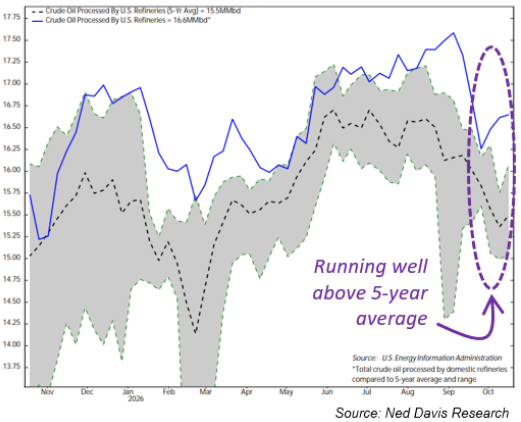
After awakening in utter darkness, the narrator of Poe's classic tale discovers a deep, dark pit in the center of the dungeon which he narrowly avoids. Likewise, in consideration of a plethora of macro factors that might portend a precipitous market fall, earlier this year we tactically made defensive adjustments to our investment strategies in actively-managed portfolios. While our deemphasis of stocks overall hindered performance to a degree amid a market more resilient than most expected, our areas of emphasis within the asset class remained impeccable. Since February we have emphasized Small Cap over Large Cap, International over US, and Value-style over Growth. Year-to-date through September, Small Cap outperformed Large Cap by nearly a full percentage point, International outperformed the US by nearly 2 percentage points, and Value outperformed Growth by 13 percentage points! Additionally, while the bond market declined amid rising interest rates, our emphasis on Cash (i.e. money market) helped. That said, many of the aforementioned potential pitfalls continue to loom large.

War, Oil, & Inflation

One of, if not the primary, factors impacting the global economy remains the war in the Middle East. What was once said to be a "four to five week" endeavor has extended beyond 7 months, and while there have been numerous head fakes in terms of a potential resolution, the conflict continues unabated. Indeed, while as recently as September the President stated, "I think the war is going to end immediately after the election," reporting in October indicates the U.S. and Israel are developing plans for major strikes on Iran following the midterms. One must therefore expect the war, higher fuel prices, and inflation to stretch into 2027.

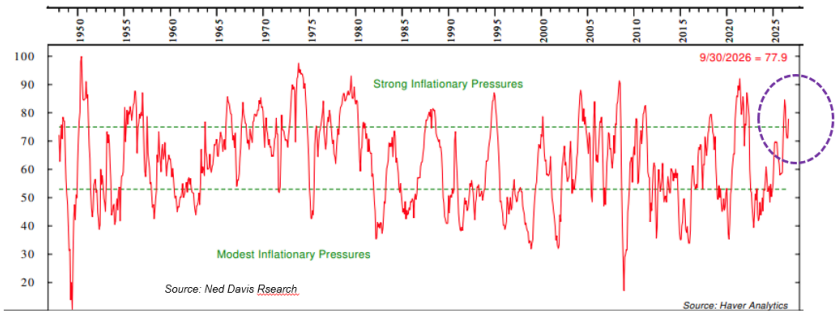
As reported in the last edition of the Wealth Watch, "crack spreads" (product prices relative to crude prices) remain near record levels and US refineries continue running near full capacity. The chart at right shows the total volume of crude oil processed by refineries remains well above 5-year averages, leaving little room for disruptions, and vulnerability related thereto exacerbated by postponing planned maintenance. Meanwhile, despite Persian Gulf exports now surpassing prewar levels, the cost of transporting crude has skyrocketed, with soaring insurance premiums, costly ship-to-ship transfers, and high hazard compensation for ship crews adding an estimated $20 to $30 per barrel in cost. As Natasha Kaneva, head of global commodities at JPMorgan said, "in April the problem was a shortage of crude; in October it is the cost of moving it."

Refinery Throughputs: Limited Spare Capacity



Source: Ned Davis Research

Beyond oil, leading indicators suggest inflation is likely to rise further in Q4 and remain elevated in 2027. In September the ISM Price Index, which tends to lead so-called "super-core" inflation (excluding energy, food and shelter costs) by 6 months, hit its highest level since mid-2022. As indicated on the chart below, strong inflationary pressures suggest that higher inflation is likely to extend into 2027 and in response the Fed will likely hike rates again.



*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Developed: MSCI EAFE Index; Int'l Emerging: MSCI Emerging Markets Index; US Inv-Grade Bonds: Bloomberg Aggregate Index; Int'l Bonds: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodities: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

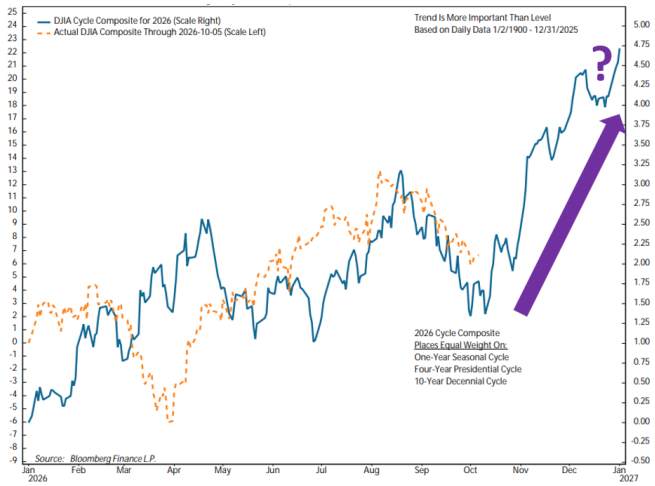
Elections, Interest Rates, & Market Action

Unlike Poe's pit, which represented an immediate and visible threat, the pendulum swung gradually and predictably. Political change often follows a similar pattern, with electoral cycles producing a recurring swing in governing influence from one side of the political spectrum to the other. Mid-term election years tend to favor the opposing party of the President, and 2026 was anticipated to be no different. Much like Poe's protagonist, polling suggests investors may similarly be observing the political pendulum swing from the right to the left.

The blue line on the chart at right shows the projected market trajectory in 2026 based on the action during the average mid-term election year, the business cycle, and seasonality. The orange dashed line shows the market's actual action, which has been fairly consistent with expectations. One notes that typically a market downturn is witnessed leading up to the election but is followed by a strong post-election rally. Historically, Q4 has seen a positive market in 80% of the last 80 years and 85% of mid-term election years. Moreover, if the most recent polls are to be believed, it would seem the Democrats have a strong chance of reclaiming both the House and Senate and, as the middle table to the right indicates, under a Republican president the market has historically preferred a Democratic congress to a split one. Finally, as shown on the bottom table at right, the third year of a presidential term—2027 in the current scenario—tends to be the strongest. By historical average standards, a post-election market rally followed by a strong 2027 might be expected. However, many wildcards remain that could threaten to derail what might otherwise be an optimistic outlook.

In addition to the complicating factors previously mentioned such as the Iran War and persistent and climbing inflation, rising interest rates and Fed hikes may indicate a counterpoint to the year-end rally narrative. By late September 2026, the 10-year Treasury yield spiked more than 1.25 percentage points in just 7 months. Historical analysis indicates that there were 13 prior similar instances and, among those cases, only about half had positive returns three months later. Meanwhile, among the 6 prior cases where the Fed's first hike occurred in Q3 as it did this year, roughly two-thirds experienced positive Q4 returns. In summary, while some indications suggest near-term market strength, a number of risk factors remain that may test its recent resilience as we close out the year and enter 2027.

Dow Jones Industrial Average Cycle Composite: 2026

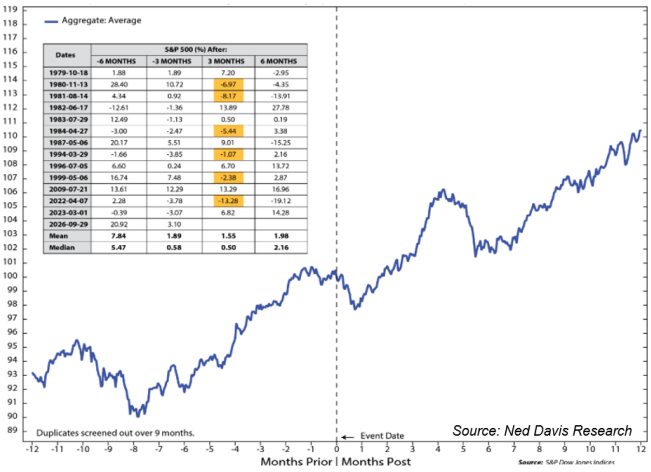


Govt. Combinations (1901 – 2026)	%Gain/Annum	% of Time
R Pres / Split Cong	-1.96%	11.17%
R Pres / Dem Cong	2.44%	17.54%

Presidential Term (1900 – 2024)	1st Yr	Mid-Tm	3rd Yr	Election Yr
Percent Up Years	56.2%	54.8%	80.6%	71.0%
Average Gain/Year	7.4%	3.4%	12.3%	7.8%
Median Gain/Year	12.8%	2.1%	14.4%	7..6%

Source: Ned Davis Research

S&P 500 When 10-Yr Treasury Up 125+ bps in 7 months



Dodging the Dungeon: Fourth Quarter & Into 2027

Investors face a host of challenges today. Inflation, energy markets, interest rates, elections, and geopolitical developments will continue to command attention. We have recently adjusted our tactical positioning accordingly for our actively-managed clients, maintaining our underweight to Equity but removing the emphasis on Small Cap. Additionally, in anticipation of rising rates, we have adjusted our Fixed Income strategy to reduce duration and interest rate vulnerability. What remains constant is that disciplined investment plans have historically outlasted political cycles, economic scares, and market corrections alike. While Poe's protagonist ultimately survived both the pit and the pendulum, his salvation did not come from predicting every danger or avoiding every threat. Rather, it came from maintaining composure amid uncertainty and adapting as circumstances evolved. The pendulum will continue to swing. The pit will always appear threatening. Yet for long-term investors, maintaining focus on destination rather than distraction remains the most reliable path to achieving financial objectives.

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