WEST SHORE BANK

Overview

The third quarter presented investors with an unusual combination of resilient economic growth, narrow equity-market gains, persistent inflation pressures, and sharply rising interest rates. Economic activity consistently exceeded expectations, corporate fundamentals remained supportive, and investment tied to artificial intelligence continued to expand. At the same time, higher energy prices, elevated inflation, growing capital requirements, and concerns surrounding government borrowing pushed Treasury yields to their highest levels in more than two decades.

Equity markets produced modest gains during the quarter, but the headline returns masked considerable weakness beneath the surface. The S&P 500 advanced 2.3% and the NASDAQ gained 2.6%, while the Dow Jones Industrial Average declined 2.3%. Small- and mid-cap stocks came under considerably more pressure, with the Russell 2000 falling 7.2%, the S&P 600 declining 7.9%, and the S&P 400 losing 6.4%. Developed international equities gained 0.8%, while emerging-market equities declined 0.4%. Even with the quarter's uneven participation, year-to-date total returns remained solid across many major equity indices.

Table 1 – Equity Total Returns – as of September 30, 2026

Equity	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
MSCI Emerging	-0.56	-0.37	23.38	29.22	24.09	8.94	9.08
NASDAQ	1.93	2.61	16.09	19.25	27.52	14.03	18.61
S&P 600	-5.57	-7.93	14.08	16.02	14.81	6.22	9.83
Russell 2000	-5.25	-7.23	13.71	16.20	17.72	6.34	9.83
S&P 500	-0.35	2.30	12.75	15.74	22.89	13.79	15.32
MSCI Developed	-3.05	0.81	10.33	15.69	18.40	9.32	9.06
S&P 400	-4.22	-6.36	9.88	11.69	14.54	8.03	10.46
Dow Jones Industrial	-4.12	-2.34	7.19	11.50	17.01	10.58	13.09

The quarter’s most notable development was the sharp increase in Treasury yields. The 10-year Treasury yield reached 5.304% intraday on September 30, surpassing the 2007 intraday peak and reaching a level last seen in May 2002. The move reflected more than a simple adjustment in Federal Reserve expectations. Stronger economic growth, persistent inflation trends, elevated oil prices, substantial government borrowing, heavy capital demands associated with artificial intelligence infrastructure, and weaker demand at Treasury auctions all contributed to the repricing of longer-term interest rates.

Capital Markets

Financial markets began the quarter with underlying support from robust S&P 500 earnings growth, continued economic expansion, and optimism surrounding artificial intelligence. FactSet estimated third-quarter S&P 500 earnings growth at 29.1% year over year as of late September, with estimates revised higher during the quarter. Despite geopolitical uncertainty and the sharp rise in Treasury yields, the VIX remained comparatively muted, suggesting that equity-market volatility did not fully reflect the

degree of uncertainty evident in interest-rate and commodity markets. As the quarter progressed, however, investors increasingly focused on geopolitical developments in the Middle East, rising oil prices, persistent inflation, and the potential for monetary policy to remain restrictive longer than previously anticipated.

Large-cap equities held up better than most other market segments, but market participation was limited. The S&P 500's 2.3% quarterly gain was supported primarily by Energy, Information Technology, and Health Care, which returned 17.2%, 7.2%, and 6.5%, respectively. Communication Services gained 3.6%. These were the only four sectors to finish the quarter higher.

The remaining seven S&P 500 sectors declined. Utilities fell 12.4%, Industrials lost 9.7%, Real Estate declined 5.6%, Consumer Discretionary fell 5.1%, Materials lost 2.8%, Consumer Staples declined 1.9%, and Financials were approximately flat at negative 0.1%. The dispersion was particularly notable because the strongest sector, Energy, outperformed the weakest sector, Utilities, by nearly 30% during the quarter.

Table 2 – S&P 500 Sector Total Returns – as of September 30, 2026

Sector	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
Energy	-2.72	17.23	40.28	42.42	14.47	23.26	10.15
Information Technology	4.47	7.20	28.38	30.20	36.60	23.54	25.95
Health Care	-0.89	6.46	10.15	23.02	11.28	7.57	10.82
Materials	-6.74	-2.81	8.82	10.04	9.66	6.46	9.66
Industrials	-4.42	-9.66	8.54	9.50	19.85	13.06	12.78
Consumer Staples	-3.26	-1.90	5.98	5.99	10.11	7.44	8.00
Real Estate	-6.14	-5.57	5.31	2.30	10.75	2.21	6.14
Communication Services	4.33	3.64	4.48	12.06	29.48	12.88	12.71
Financials	-7.16	-0.12	-1.30	0.69	19.12	9.23	12.87
Utilities	-5.90	-12.39	-5.65	-6.97	13.63	7.57	8.33
Consumer Discretionary	-5.82	-5.09	-5.82	-5.15	13.48	5.63	12.11

Unlike the broader participation evident at various points earlier in the year, third-quarter performance was concentrated in a relatively small group of sectors and large-cap companies. Energy benefited from elevated oil prices and geopolitical uncertainty, while Information Technology continued to draw support from AI-related investment and earnings growth. The declines in small-cap, mid-cap, cyclical, rate-sensitive, and defensive sectors illustrate that the quarter's positive headline return was not broadly shared.

This narrow participation is an important distinction. The S&P 500 advanced, but seven of its eleven sectors declined, and most major domestic equity indices finished the quarter lower. Rather than signaling uniformly improving market conditions, the quarter reflected a selective market in which a handful of themes continued to offset weakness across much of the broader equity landscape.

Fixed-income markets faced considerably greater pressure as Treasury yields moved sharply higher. The Bloomberg U.S. Aggregate Bond Index declined 3.5% for the quarter, while the Intermediate

Government/Credit Index lost 1.9%. Municipal bonds came under even greater pressure, with the broad Municipal Bond Index declining 6.3% and the Michigan Municipal Index falling 6.5%. High-yield bonds declined a more modest 1.8%, as credit conditions remained generally supportive despite the increase in underlying Treasury yields.

Table 3 – Fixed Income Total Returns – as of September 30, 2026

Fixed Income	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
Bloomberg High Yield	-2.52	-1.82	0.10	1.41	8.03	3.60	5.05
Bloomberg Inter Gov't/Credit	-1.66	-1.88	-1.49	-0.31	4.31	0.83	1.71
Bloomberg U.S. Aggregate	-2.61	-3.51	-2.91	-1.84	4.06	-0.64	1.13
Barclays Michigan Muni	-4.54	-6.47	-4.14	-2.44	3.01	-0.19	1.67
Bloomberg Municipal	-4.36	-6.35	-4.18	-2.68	2.89	-0.21	1.51

Treasury yields moved higher throughout much of the quarter before accelerating sharply in September. The 10-year Treasury yield rose to 4.97% by September 11, climbed above 5.00% the following week, and reached 5.304% intraday on September 30. That final move carried the yield above its 2007 intraday peak and to its highest level since May 2002.

Several interrelated factors contributed to the backup:

1. **Stronger economic growth.** Economic data repeatedly exceeded expectations, reducing concerns about a near-term slowdown and prompting investors to reassess how restrictive monetary policy would need to remain. The final second-quarter GDP estimate and the third-quarter GDPNow estimate reinforced this view.
2. **Persistent inflation and higher energy prices.** Core inflation remained above the Federal Reserve's comfort level, while elevated oil prices associated with the Iran conflict added renewed pressure to the inflation outlook. The September ISM manufacturing report also showed a sharp increase in its prices index.
3. **Federal Reserve policy expectations.** As growth remained resilient and inflation pressures persisted, investors increased expectations that policy rates could remain elevated or move higher. The Federal Reserve's September rate increase and Chair Warsh's hawkish comments reinforced the market's reassessment of the future path of interest rates.
4. **Treasury supply and fiscal concerns.** Persistent federal deficits, rising interest expense, and substantial government borrowing increased the amount of debt private investors were required to absorb. An underwhelming Treasury buyback operation and weak auction demand added to concerns about the balance between Treasury supply and available demand.
5. **AI-related demand for capital.** The expansion of data centers, semiconductor capacity, energy infrastructure, and other AI-related investment increased competition for long-term capital. This capital-intensive buildout added another source of demand for financing at a time when government borrowing was already elevated.

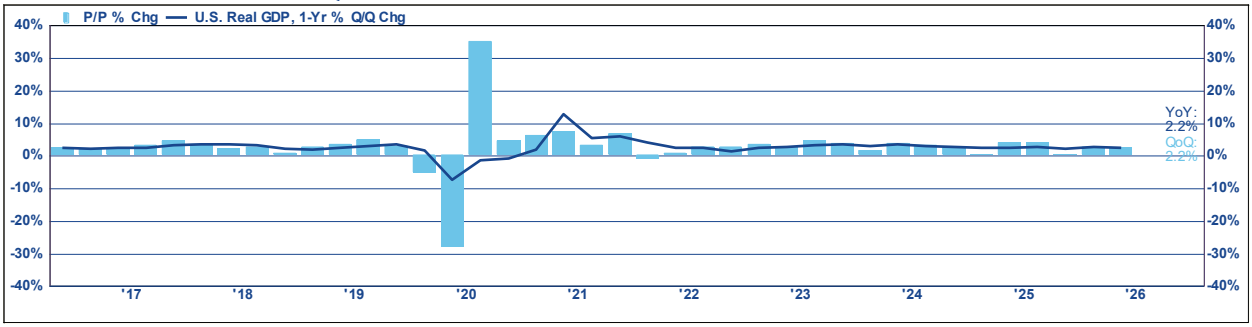
Despite the increase in Treasury yields, corporate credit spreads remained remarkably tight throughout the quarter, signaling continued confidence in corporate balance sheets and economic stability. The

resilience of credit markets helped limit downside pressure in high-yield bonds and provided an important indication that financial conditions remained considerably healthy.

Economy

The U.S. economy continued to demonstrate greater resilience than widely anticipated. The Bureau of Economic Analysis' third estimate showed that real GDP expanded at a 2.2% annualized rate during the second quarter, exceeding the 1.5% consensus estimate and representing a 0.7 percentage-point upward revision from the prior estimate. The revision primarily reflected stronger investment, consumer spending, and government spending.

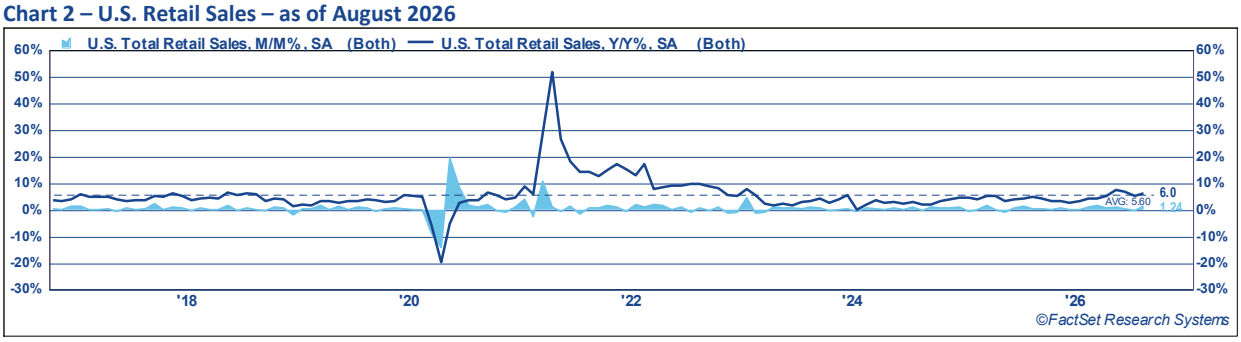
Chart 1 – U.S. Real GDP – as of 2Q26



Importantly, underlying private demand was stronger than the headline GDP figure. Real final sales to private domestic purchasers, which combine consumer spending and private fixed investment, increased at a 4.6% annualized pace. Consumer spending, investment, and exports contributed to growth, while rising imports reduced the headline result.

Momentum appeared to carry into the third quarter. The Federal Reserve Bank of Atlanta's GDPNow model estimated third-quarter real GDP growth at a 3.7% annualized rate as of October 1. The estimate began at 5.0% on July 30, reached a high of 6.2% in early August, and declined to 3.7% following the late-September GDP, personal income, spending, trade, manufacturing, and construction reports. GDPNow is a model-based running estimate rather than an official Federal Reserve forecast.

Chart 2 – U.S. Retail Sales – as of August 2026



One of the more notable developments during the quarter was the market's increasing recognition that economic growth may be stronger than previously anticipated. Corporate earnings, consumer spending, labor market conditions, and business investment activity all pointed toward an economy that remains fundamentally healthy despite the weight of higher interest rates and stubborn inflation.

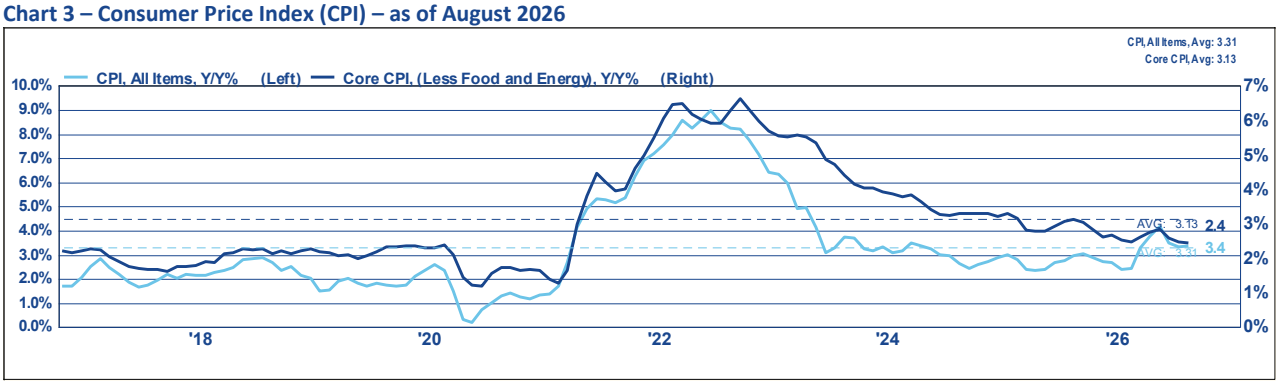
Taken together, the final second-quarter GDP report and the GDPNow estimate suggest the economy entered the fourth quarter with considerable momentum. Consumer activity and business investment remained firm, while AI-related capital spending continued to support equipment, intellectual property, data-center construction, and associated infrastructure. Economic resilience provided support for corporate earnings, but it also complicated the inflation and monetary-policy outlook.

Federal Reserve

Monetary policy expectations shifted meaningfully during the quarter. As incoming economic data remained firm and inflation pressures persisted, the market increasingly concluded that the Federal Reserve had limited room to pursue a more accommodative policy.

Inflation remained a central concern. While some areas experienced moderation, broader inflation measures continued to reflect sticky pricing pressures across key sectors of the economy. Elevated energy prices at various points during the quarter, rising wage costs, and continued strength in consumer demand contributed to inflation remaining above levels consistent with the Federal Reserve's long-term target.

Chart 3 – Consumer Price Index (CPI) – as of August 2026



At its September FOMC meeting, the Federal Reserve raised its target rate to 4.00%. Chair Kevin Warsh characterized the action as a removal of accommodation rather than a move toward broadly restrictive policy. The Federal Reserve's mandate is to promote maximum employment and price stability (low inflation). With labor-market conditions balanced and stable, the employment side of that mandate appeared broadly consistent with the Committee's objectives, allowing policymakers to focus more directly on persistent inflation risks. Warsh cited continued strength in credit growth, labor markets, consumer spending, corporate earnings, and capital investment while emphasizing that inflation remained above the Committee’s comfort level.

Chair Warsh also connected the increase in long-term rates to three broad developments: stronger economic growth, substantial capital requirements associated with the AI buildout, and geopolitical tensions affecting energy prices and inflation. Those drivers were compounded by rising Treasury issuance and concerns about the private market's capacity to absorb growing government debt supply.

The result was a material repricing across the yield curve. Rather than reflecting a single economic report or Federal Reserve decision, the rise in yields represented the cumulative effect of stronger nominal growth, persistent inflation, expanding public and private capital needs, and greater uncertainty surrounding the long-term equilibrium level of interest rates.

Closing Perspective

The third quarter reflected a market supported by economic and corporate fundamentals but increasingly constrained by the cost of capital. Economic growth remained resilient, consumer and business spending continued to expand, and AI-related investment provided an important source of momentum. Those same strengths, however, reduced expectations for easier monetary policy and contributed to the sharp repricing of Treasury yields.

Equity-market results also required a closer look. The S&P 500 and NASDAQ advanced, but the gains were concentrated and did not reflect the experience of most sectors or broader market indices. Seven of eleven S&P 500 sectors declined, as did the Dow, small-cap stocks, mid-cap stocks, and emerging markets. The quarter therefore reflected positive large-cap index performance without broad participation.

Fixed-income markets bore the brunt of the adjustment. The combination of stronger growth, persistent inflation, higher energy prices, a less accommodative Federal Reserve, expanding Treasury supply, and growing AI-related capital needs pushed the 10-year Treasury yield to a level last seen in 2002.

Financial markets entered the fourth quarter with solid economic momentum but a more demanding interest-rate backdrop. The central tension remains unchanged: resilient growth and corporate earnings continue to support financial assets, while persistent inflation and higher borrowing costs place increasing pressure on valuations, bond prices, and the broader economy.

Prepared by Perry Adams – SVP & Director – West Shore Bank Wealth Management – October 2 , 2026

Sources: FactSet, Federal Reserve, U.S Bureau of Economic Analysis, Federal Reserve Bank of Atlanta, Wall Street Journal, WSB Weekly, ISM, U.S. Bureau of Labor Statistics, U.S. Census Bureau

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