

Market Commentary



Weekly perspective on current market sentiment

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Last week's S&P 500 Index: -0.3%

Strong economy, stubborn yields

Key takeaways

- Economic growth and the AI boom are supporting equities while simultaneously reducing the likelihood for lower Treasury yields.
- While higher rates may increase market volatility, they also create a broader opportunity set for investors.

Strong growth and the AI (artificial intelligence) investment boom have helped lift equities — but they may also be keeping Treasury yields higher for longer. Rising yields may appear worrisome, but the underlying drivers point to a more constructive outlook. For investors, the key question is what this tension could mean for portfolios.

Rising oil prices do not tell the full story behind rising Treasury yields. Yields reflect a mix of inflation expectations, inflation-adjusted (real) yields, and term premiums (additional return for holding longer-term bonds). Since 2025, real yields have risen faster than inflation expectations, suggesting rising Treasury yields are also reflecting a growing economy.

Business activity grew in September with S&P's Global Flash Purchasing Managers' Index reaching a five-year high. Notably, an uptick in the prices paid component reflected growing price inflation in the costs of semiconductors and other key industrial components as demand continued to outpace supply. Meanwhile, unemployment remains relatively low and consumer spending has exceeded expectations. Together, this suggests the economy could support higher interest rates. That resilience matters because it helps explain why we remain favorable on U.S. large-cap equities despite the rise in yields. Additionally, consensus estimates continue to forecast double-digit earnings growth for the S&P 500 Index in 2026.

Beyond the economy, the scale of the AI boom can't be ignored. Estimates suggest spending on data centers and AI infrastructure among the eight largest cloud providers in 2027 will account for 3.7% of our U.S. nominal gross domestic product forecasts. Only the 19th-century buildout of the railroads was a larger investment cycle.¹ This spending flows through the economy via physical infrastructure, including data centers, power generation, and construction, creating demand for capital, labor, and resources. These same forces supporting equities are also driving Treasury yields higher. While they support earnings growth, they also increase demand for capital and resources. As competition for resources and capital grows, bond investors may continue to demand higher returns to lend, reducing the likelihood of a significant decline in yields.

For investors, the takeaway is not to ignore the risks but to recognize that some of the same forces supporting equities are also creating opportunities elsewhere. While higher rates, energy prices, and policy uncertainty may increase near-term volatility, we believe economic growth and the AI investment cycle are supportive of U.S. large-cap equities. For bond investors, higher rates can lead to lower prices today but can also generate stronger future total returns as the stream of coupon payments is reinvested at more attractive rates. For investors concerned with inflation or geopolitical risks, commodities can provide an attractive hedge for portfolios.

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1. For more information, see Wells Fargo Investment Institute's "Investment Strategy Report Equities Spotlight: Go the Distance," October 5, 2026.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

Definitions

S&P Global Purchasing Managers' Index is a monthly survey-based diffusion index covering manufacturing and services across major global economies.

S&P Global Purchasing Managers' Flash Index releases are among the earliest macro data each month, often arriving a week before the final Institute for Supply Management equivalents. Markets reprice on the flash, particularly when surprises are large.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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