Week in review and ahead (vol.39-26)

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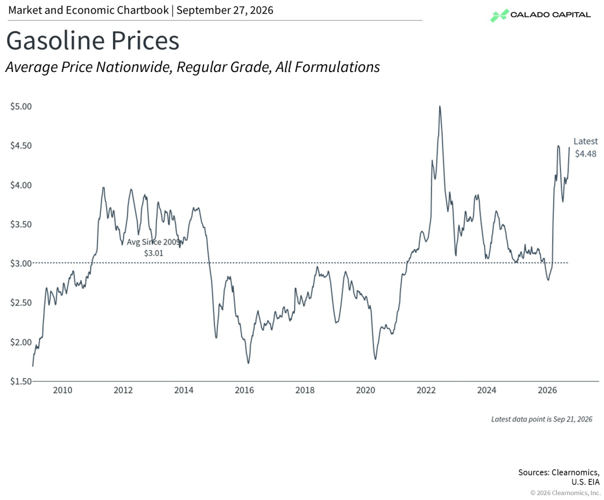
September 27, 2026

Week in review

U.S. equity markets mostly advanced during the week as reports emerged that the United States and Iran had resumed diplomatic engagement aimed at de-escalating the conflict and facilitating the reopening of the Strait of Hormuz, easing concerns surrounding global energy supplies and supporting risk sentiment. Although the economic calendar was relatively light, geopolitical developments remained firmly in focus as the energy-driven supply shock continued to place significant upward pressure on gas and diesel prices, both domestically and abroad.

Gas prices are nearing the highs since the US-Iran conflict began in late February, while the sharp rise in diesel prices has become an increasingly important inflationary consideration. Since featuring diesel as the "Number of the Week" in our Vol. 36-26 newsletter, when the national average reached a record $5.85 per gallon, prices continued to climb and now stand at nearly $6.50 per gallon less than one month later. The acceleration has heightened concerns that transportation and freight costs could increasingly filter through to broader consumer prices, potentially complicating the ongoing inflation outlook.



Treasury yields moved decisively higher once again during the week. The 2-year Treasury yield rose approximately 10 basis points ("bps") to 4.86%, while the 10-year and 30-year Treasury yields increased by 17bps and 16bps, respectively, to approximately 5.17%, the highest level since July 2007, and 5.49%. The move was fueled in part by stronger-than-expected September business activity estimates from S&P Global's PMI surveys, which pointed to the strongest pace of economic activity in roughly five (5) years and reinforced concerns that the Federal Reserve may need to maintain a restrictive policy stance for longer than previously anticipated.

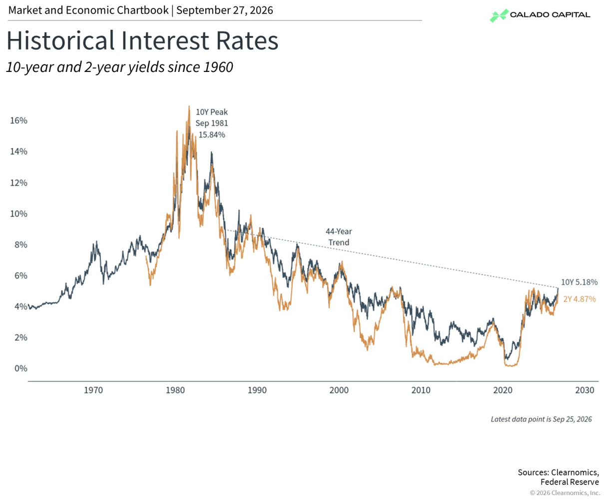
Against this backdrop, U.S. equity market performance remained mixed. The S&P 500 advanced 1.2% for the week, while the Nasdaq Composite gained 2.1%, benefiting from continued risk-on sentiment towards artificial intelligence and large-cap technology companies, with the index reaching a fresh all-time high earlier in the week. The Dow Jones Industrial Average posted a more modest gain of 0.3%, while the Russell 2000 declined 0.8%, extending its recent underperformance.

Importantly, the advance in U.S. equities continues to be characterized by narrow market leadership. Despite the S&P 500 rallying to within 1% of a record high early in the week, underlying market breadth remained weak, with more index constituents registering new 52-week lows than new highs. The divergence suggests that a relatively small group of mega-cap technology companies, led by the so-called "Magnificent Seven," continues to account for a disproportionate share of index performance, leaving the broader market less robust than headline index levels may imply.

International markets were similarly mixed. While most major markets in Asia moved lower for the week, European markets generally stabilized posting moderate gains for the week.

In Asia, equity performance diverged as Chinese, Hong Kong, and Indian markets declined amid trade uncertainty, higher oil prices, rising global bond yields, and continued foreign investor outflows. By contrast, Japanese and South Korean equities advanced, supported by strength in technology, semiconductor, and export-oriented companies, reflecting continued investor confidence in the region's earnings outlook.

European equities posted modest gains as lower oil prices helped ease inflation concerns and allowed the STOXX Europe 600 to snap a three-week losing streak, though elevated bond yields continued to temper sentiment. Germany's DAX and the United Kingdom's FTSE 100 outperformed on strength in industrial, banking, and mining shares, while France's CAC 40 lagged as weakness in luxury and consumer sectors limited the broader regional rebound.



Week in review – US macroeconomics

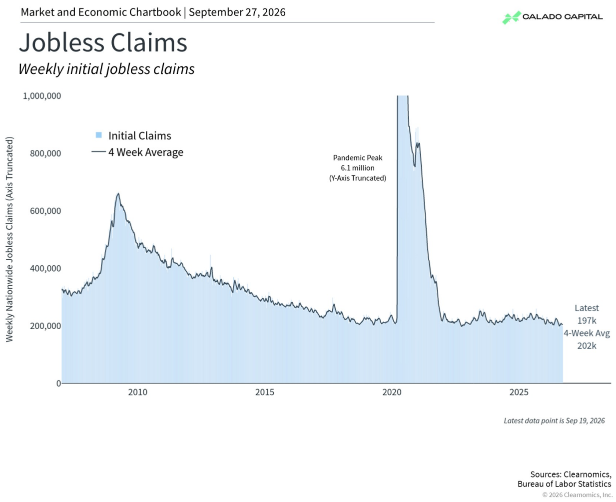
With the economic calendar relatively light, the week's releases were headlined by S&P Global's flash PMIs for September, the preliminary read on business activity for the month, which pointed to an economy running hotter than expected. The final University of Michigan consumer sentiment reading, August new home sales, durable goods orders, and weekly jobless claims rounded out the data slate, alongside a closely watched summit between the U.S. and China.

On the geopolitical front, President Trump and China's President Xi met in the United States. The summit produced little in the way of tangible outcomes. Its most concrete result was an agreement to extend the existing trade truce by roughly two months, pushing the deadline on tariffs and a broader trade framework to January 10, 2027. Markets read the meeting as a modest positive, delivering stability rather than a breakthrough, while leaving the harder questions on trade, AI technology, and tariffs unresolved.

The flash PMIs for September are signaling the strongest business activity in five years. The manufacturing index jumped to 57.0, well above the 53.6 expected, while the service sector surged to 58.7 against a 56.6 estimate. The composite reading rose to 58.4, up sharply from 56.0 the prior month. The breadth and strength of the readings suggested that momentum, far from fading, is accelerating into the fourth quarter, a striking signal given the Fed's recent move to tighten policy. The surveys also dovetail with the Atlanta Fed's GDPNow model, which now pegs third-quarter real GDP growth at 5%, buoyed by last week's robust retail sales, a nowcast pointing to an economy expanding rapidly that very well may implicate that the Fed may tighten monetary policy further.

The remaining data reinforced the picture of an economy that remains resilient. Initial jobless claims fell to 197,000, below the 201,000 expected and last week's 198,000, extending their run beneath historical norms. August new home sales rose 6.4% to a 680,000 annual pace, ahead of the 620,000 expected and July's 640,000, a rebound after the prior month's 4.3% decline. Even so, the housing market remains under considerable pressure. The 30-year mortgage rate jumped again this week, reaching 7.45% on Thursday, its highest level in more than two years, while building costs continue to climb and median home prices sit at elevated, record levels. Durable goods orders were unchanged in August, comfortably better than the 0.4% decline expected and following a strong 0.9% gain in July, while orders excluding transportation rose 0.3%, just shy of the 0.4% estimate. The one soft spot was sentiment: the final September University of Michigan reading came in at 48.1, in line with the preliminary estimate but down from 51.7 and extending its decline since July, though still above this year's low of 44.8 reached in May.

The clearest market signal this past week, however, came from bonds. Yields continued to climb, both in the U.S. and globally, jumping after the unexpectedly strong September flash PMIs suggested the economy retains considerable momentum. For a Fed already leaning hawkish, such robust activity only strengthens the case for further tightening. Accordingly, markets have moved to price a greater likelihood that the Committee raises rates again, reinforcing the upward pressure on borrowing costs at home and abroad.



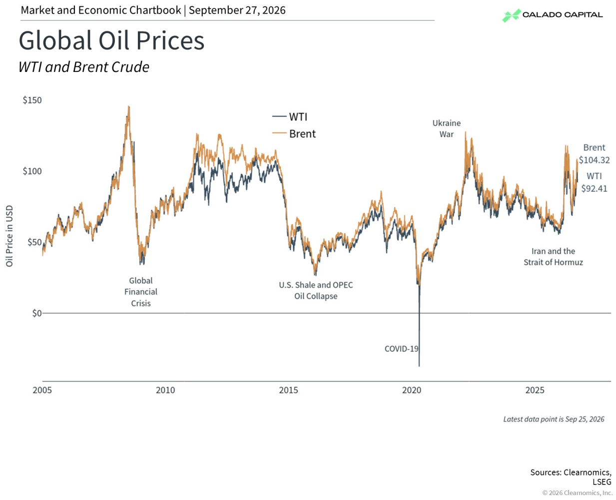
Week ahead

The week ahead will be dominated by the release of the August PCE Price Index, widely regarded as the Federal Reserve's preferred inflation metric. Core PCE is expected to edge higher, rising 0.3% in the month and 3.4% from a year earlier, an increase of roughly 0.1 percentage point relative to the prior readings. Alongside inflation data, the August employment report will provide an important update on labor market conditions. Collectively, these reports are poised to significantly influence market expectations regarding the timing and magnitude of future Fed policy decisions.

The broader data calendar is also packed with key releases. August personal income and consumption figures will accompany the PCE report, while JOLTS job openings and the final reading of second-quarter GDP, anticipated to confirm growth at 1.5%, will offer further insight into the resilience of economic activity. Additional releases, including the Conference Board's consumer confidence index, the S&P/Case-Shiller home price index, and weekly jobless claims, will help complete the picture of both household demand and labor market health.

Investors will also keep a close eye on developments in Washington. While the September 30 fiscal year-end had been viewed as a potential source of uncertainty, concerns over an imminent government shutdown have largely subsided following the passage of a continuing resolution that funds federal agencies through December 11, 2026. At the same time, Congress has yet to complete the FY2027 appropriations process, leaving longer-term funding negotiations unresolved and ensuring fiscal policy remains a consideration for markets in the months ahead.

Against a backdrop of heightened sensitivity to inflation developments, the PCE report is likely to command outsized market attention. With policymakers seeking greater confidence that price pressures are moderating and investors recalibrating expectations following the Fed's recent return to tightening, any deviation from consensus could trigger notable moves across fixed income, equity, and currency markets. While fiscal negotiations may attract headlines, inflation and labor market data are expected to remain the primary drivers of market sentiment in the week ahead.



Number of the Week: $12

The spread between Brent crude and the U.S. benchmark WTI widened to approximately $12 per barrel last week, its largest differential since the early stages of the U.S.-Iran conflict. Brent settled at $104.45 per barrel by weekend, highlighting the significant geopolitical premium that continues to underpin global energy markets.

The move reflected renewed concern over the trajectory of the U.S.-Iran conflict and the security of oil flows through the Strait of Hormuz. Brent had fallen below the $100 threshold in previous weeks amid reports of potential diplomatic engagement between Washington and Tehran, only to rebound sharply as optimism surrounding a negotiated resolution faded. Markets increasingly appear reluctant to anchor to a single oil-price outlook. In a sign of the unusually high degree of uncertainty, JPMorgan has reportedly withdrawn its oil forecast, citing the absence of a clear endgame to the conflict and the breakdown of assumptions that economic pressures alone would compel a diplomatic resolution.

The widening Brent-WTI differential underscores the market's reassessment of geopolitical risk, particularly the vulnerabilities associated with seaborne Middle Eastern crude supplies. While oil continues to transit the Strait of Hormuz, shipping activity remains below historical norms as market participants adopt increasingly cautious logistical strategies. The resulting supply uncertainty has become a key driver of crude pricing, reinforcing the premium attached to internationally traded barrels.

The broader economic implications are substantial. With diplomatic progress appearing limited and neither side demonstrating a willingness to concede, the risk of further upward pressure on energy prices remains elevated. Such an outcome would intensify an energy-driven inflation shock that is already filtering through global economies.

For the Fed and central banks globally, higher oil prices would further complicate an already challenging policy environment. Policymakers are still grappling with persistent inflation while facing risks of moderating economic growth. A renewed surge in energy costs could strengthen the case for maintaining restrictive monetary policy for longer, even as downside risks to activity accumulate. In that sense, oil has re-emerged as arguably the most important macroeconomic variable shaping the global inflation outlook and, by extension, the future path of interest rates.

If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at claudio@caladocapital.com.

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