PERSPECTIVES

Quarterly Review: Cautious Investors Tap the Brakes

Oct 01, 2026

KEY TAKEAWAYS

- The S&P 500 hit record levels on the heels of continued gains for AI companies but pulled back late in the quarter.
- The US Federal Reserve lifted interest rates for the first time in more than three years.
- The yield on the benchmark 10-year US Treasury spiked above 5%, hitting its highest level since 2002.

After a strong start to the year for US stocks, the engine that has driven them upward for the better part of four years shifted nearer to "idle" in the third quarter. The S&P 500 was able to climb to fresh highs in August, helped by technology stocks, but the gains wouldn't hold.[1] The slowdown came as tensions continued in the Middle East, scrutiny increased about the pace of AI development, and bond yields rose around the world.[2] The US Federal Reserve lifted interest rates for the first time in more than three years amid persistently high inflation. In the bond market, US Treasury prices remained lower, and the benchmark 10-year yield spiked above 5%, hitting its highest level since 2002.[3] Equity returns in developed international markets were slightly lower than in the US, and emerging markets lagged them for the quarter in an otherwise strong year.

The S&P 500 rose 2.3%, and the tech-heavy Nasdaq added 2.6% as of September 30.[4] The tech companies' highs over the summer came on the heels of continued gains for AI stocks and as SpaceX debuted on public markets in June. But the stock closed the quarter below peaks hit after its IPO, which was the largest ever.[5] It's worth noting that, historically, IPOs have tended to underperform the market in their first year. Late in the quarter, AI stocks pulled back amid, among other things, discussion of the companies taking a more cautious approach to their models' advances.[6]

Oil prices surged as US tensions with Iran continued—especially around the Strait of Hormuz, a vital shipping lane for crude.[7] However, the US economy, which has become more services oriented, is less dependent on oil than it has been at times in the past. Furthermore, the US is now a net exporter of oil, so the impact of price shocks has become more muted as crude sources have diversified.[8]

Global equities, as measured by the MSCI All Country World Index (net dividends), rose

1.6% as of September 30. Stocks in developed international markets outside the US added 0.9%, as measured by the MSCI World ex USA Index (net dividends). The MSCI Emerging Markets Index (net dividends) dropped 0.4% but remained well higher for the year, up 23.4%, nearly doubling developed markets' gains.[9]

NEW GLOBAL CONTENDERS "EMERGE"

The strong year for emerging markets has been led by Taiwan and South Korea, vaulting the countries into the ranks of the world's 10 largest stock markets. Much of this outperformance has been driven by semiconductor leaders such as TSMC, Samsung, and SK Hynix, which provide chips for AI-related companies.[10] These strong returns are a reminder that outperformance can emerge anywhere and that diversified portfolios that include a broad range of companies can allow investors to capture returns where they appear.

Small cap and value stocks, or those with low relative prices, beat large caps and growth stocks in developed markets outside the US and in emerging markets. But in the US, while value topped growth, small caps lagged large caps.[11] Elsewhere, high profitability stocks outpaced low profitability stocks in global developed markets, while the opposite was true in emerging markets.[12]

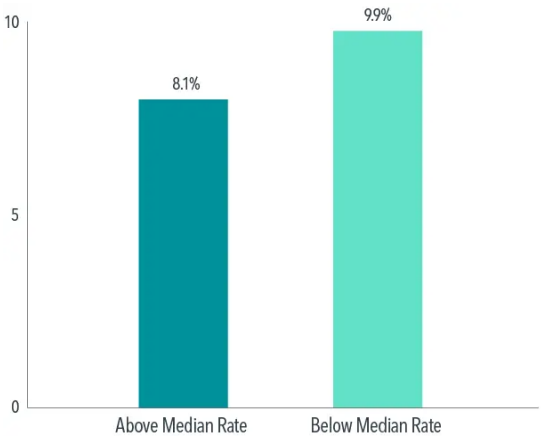
A UNIFIED FED LIFTS THE LEVEL

The US Federal Reserve raised the federal-funds rate to a range between 3.75% and 4% at its most recent meeting in September.[13] The vote in favor of a rate hike, which was the first since July 2023, was unanimous, unlike some other recent Fed decisions. Headline inflation remained elevated at 3.4% in August, while core inflation, which excludes more volatile food and energy items, rose 2.4% from a year ago.[14]

In the bond market, US Treasuries fell 3.0%, sending the yield on the benchmark 10-year Treasury up to 5.29% as of September 30.[15] The broader bond market was also lower, with the Bloomberg US Aggregate Bond Index down 3.5% and the Bloomberg Global Aggregate Bond Index (hedged to USD), a broad benchmark of sovereign and corporate debt, falling 2.5% as of September 30.[16]

With yields at their highest levels in years, investors may ask whether it makes sense to trade some equity exposure for more weight in relatively high-yielding fixed income. But discount rates for stocks factor in current interest rates. All else equal, higher bond yields should lead to higher expected stock returns. In other words, the premium for stocks over bonds may not shrink just because of higher rates.

Exhibit 1
Stocks Shrug?
Average annual equity premium conditional on one-month Treasury bill rates at start of year, 1927–2025



Past performance is not a guarantee of future results. Actual investment returns may be lower.

Equity premium is the return of the S&P 500 Index in excess of US Treasury bills. S&P data © 2026 S&P Dow Jones Indices LLC, a division of S&P Global. One-month Treasury Bill returns from Ken French data ***library****.*

Looking at the US equity premium, it has historically been unrelated to the level of interest rates. In years when the one-month US Treasury bill rate was below its historical median, the average equity premium was about 9.9% versus 8.1% in above-median-rate years (see **Exhibit 1**). However, that difference isn't statistically reliable.[17] Given that the evidence suggests the excess returns for stocks over bills are similar regardless of interest rate level, investors should be cautious changing their stock-bond mix based on current yields.

REASONS FOR RESOLVE

The US government debt level this summer topped $40 trillion.[18] Investors may find this level of debt concerning and wonder whether a change is needed in their portfolios. Debt concerns have been around for a while and were cited by Moody's when downgrading the US credit rating last year. Judging by credit default swap (CDS) spreads, which reflect the cost to insure against the US defaulting on its sovereign debt, it doesn't appear the market's assessment has gotten any worse. For the past three years, the CDS rate has been around the same level, apart from a brief spike in April 2025.

This is another important reminder for investors that market prices reflect expectations for the future. Those expectations include government debt levels and any perceived implications for stocks and bonds. Investors may be better off sticking with their plan and not changing their asset allocation in response to a notable, if not shocking, milestone.

LEARN MORE

The Market's Fed Watch in Action

Beyond Borders: The Ex US Opportunity Set

Why Investors Need Less FOMO and More Patience

How Much Impact Does the President Have on Stocks

1. S&P data © 2026 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Data as of September 30; Rob Curran, "US Stocks Rise, S&P 500 Closes at Record High," *The Wall Street Journal*, August 13, 2026.

2. Tom Westbrook and Amanda Cooper, "Global Bond Yields Hit Fresh Highs, Raising Stakes for Big Borrowers," Reuters, September 15, 2026.

3. Returns are based on the Bloomberg US Treasury Bond Index as of September 30. Bloomberg data is provided by Bloomberg Finance LP. Source for US Treasuries: US Department of the Treasury.

4. S&P data and NASDAQ. Data as of September 30.

5. Corrie Driebusch, "SpaceX Officially Raises $75 Billion in Record-Breaking IPO," *The Wall Street Journal*, June 11, 2026. SpaceX peaked at $225.62 per share on June 16, shortly after its IPO; it finished the quarter at $150.86 per share.

6. Karen Gilchrest, "AI Stocks Stumble Amid Growing Safety Fears," Morningstar, September 14, 2026.

7. Farhan Rafid, "Oil Prices Rise as Renewed US-Iran Fighting Deepens Hormuz Supply Risks," *The Wall Street Journal*, September 1, 2026.

8. "From Net Oil Importer to Net Oil Exporter," Federal Reserve Bank of St. Louis, April 23, 2026.

9. MSCI data © MSCI 2026, all rights reserved. Data as of September 30.

10. Yuvraj Malik, "Are Emerging Markets Now an AI Trade? TSMC, Samsung, SK Hynix Drive More than Half the Gains," Yahoo! Finance, August 24, 2026.

11. The MSCI All Country World ex USA Small Cap Index advanced 2.1%, while the larger cap MSCI All Country World-Ex USA Index rose 0.5%; the MSCI All Country World ex USA Value Index gained 3.5%, while the MSCI All Country World ex USA Growth Index fell 2.5%. The Russell 3000 Value Index added 2.3%, while the Russell 3000 Growth Index rose 0.5%; the Russell 2000 Index (small caps) declined 7.2%, while the Russell 1000 Index (large caps) added 1.8%. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell indices. MSCI data © MSCI 2026, all rights reserved. Data as of September 30.

12. The Fama/French Developed High Profitability Index gained 2.3% versus a decrease of 0.6% for its low profitability counterpart as of September 30; the Fama/French Emerging Markets High Profitability Index fell 2.2%, while its low profitability counterpart added 1.7% as of September 30. **Past performance is no guarantee of future results. Actual returns may be lower.** The Dimensional and Fama/French Indices represent academic concepts that may be used in portfolio construction and are not available for direct investment or for use as a benchmark. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. See "Index Descriptions" in the appendix for descriptions of the Fama/French index data.

13. "Federal Reserve Issues FOMC Statement," Federal Reserve, September 16, 2026.

14. Jeff Cox, "Inflation Persisted in August, Potentially Locking in a Fed Interest Rate Hike," *CNBC*, September 11, 2026.

15. "Daily Treasury Par Yield Curve Rates," US Department of the Treasury. Data as of September 30.

16. Bloomberg data provided by Bloomberg Finance LP.

17. The precision around the difference in these averages, measured using what's known as a *t*-test, is below the threshold required to distinguish a signal from noise.

18. Alan Rappeport, "US Debt Hits $40 Trillion as America's Borrowing Binge Continues," *The New York Times*, August 19, 2026.

Bond yield: The interest rate an investor earns on a bond.

Corporate debt: Debt securities issued by corporations to fund various business needs.

Credit default swap: A contract that acts as insurance where the seller of the swap agrees to compensate the buyer if a debt defaults.

Developed international markets: Markets of developed countries outside the US.

Discount rate: A financial metric used to determine the present value of future cash flows.

Emerging markets: Markets of countries transitioning from developing to developed status.

Equity premium: The return difference between stocks and a risk-free asset, such as short-term Treasury bills.

Federal-funds rate: The overnight interest rate at which one depository institution (like a bank) lends to another institution some of its funds that are held at the US Federal Reserve.

Global equities: Markets combining domestic (US) and international stocks into one index.

Growth stocks: Stocks trading at a high price relative to book value or earnings.

High profitability stocks: Stocks of issuers with high relative operating profits.

Inflation: Data is as defined by the consumer price index (CPI) from the US Bureau of Labor Statistics; the core CPI is an aggregate of prices paid by urban consumers for a typical basket of goods, excluding food and energy.

Large cap stocks: Stock with a relatively large market capitalization.

Low profitability stocks: Stocks of issuers with low relative operating profits.

Small cap stocks: Stock with a relatively small market capitalization.

Sovereign credit rating: An assessment of a country's creditworthiness. Ratings are published by credit rating agencies.

Sovereign debt: Debt securities issued by countries to fund various needs.

t-statistic: A statistical quantity commonly used to test whether a sample average is reliably different from a specified value (e.g., zero). Researchers often cite an absolute t-statistic value of at least 2.0 as the threshold for statistical reliability.

Value stocks: Stocks trading at a low price relative to book value or earnings.

The Fama/French Indices represent academic concepts that may be used in portfolio construction and are not available for direct investment or for use as a benchmark.

Results shown during periods prior to each index's inception date do not represent actual returns of the respective index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

Fama/French Developed High Profitability Index: Provided by Fama/French from Bloomberg data. Includes stocks in the upper 30% operating profitability (OP) range in each region; companies weighted by float-adjusted market cap. Rebalanced annually in June. OP for June of year t is annual revenues minus cost of goods sold; interest expense; and selling, general, and administrative expenses, divided by book equity for the last fiscal year-end in t – 1.

Fama/French Emerging Markets High Profitability Index: July 1991–present: Courtesy of Fama/French from Bloomberg and IFC securities data. Includes stocks in the upper 30% operating profitability range in each country; companies weighted by float-adjusted market cap; rebalanced annually in June. OP for June of year t is annual revenues minus cost of goods sold; interest expense; and selling, general, and administrative expenses, divided by book equity for the last fiscal year-end in t – 1.

Fama/French Developed Low Profitability Index: July 1990–Present: Courtesy of Fama/French from Bloomberg securities data. Includes stocks in the lower 30% operating profitability range in each region; companies weighted by float-adjusted market cap; rebalanced annually in June. OP for June of year t is annual revenues minus cost of goods sold; interest expense; and selling, general, and administrative expenses; divided by book equity for the last fiscal year end in t – 1.

Fama/French Emerging Markets Low Profitability Index: July 1991–Present: Courtesy of Fama/French from Bloomberg and IFC securities data. Includes stocks in the lower 30% operating profitability range in each country; companies weighted by float-adjusted market cap; rebalanced annually in June. OP for June of year t is annual revenues minus cost of goods sold; interest expense; and selling, general, and administrative expenses; divided by book equity for the last fiscal year end in t – 1.

Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

This information is intended for educational purposes and should not be considered a recommendation to buy or sell a particular security. Named securities may be held in accounts managed by Dimensional.

The information in this material is intended for the recipient's background information and use only. It is provided in good faith and without any warranty or representation as to accuracy or completeness. Information and opinions presented in this material have been obtained or derived from sources believed by Dimensional to be reliable, and Dimensional has reasonable grounds to believe that all factual information herein is true as at the date of this material. It does not constitute investment advice, a recommendation, or an offer of any services or products for sale and is not intended to provide a sufficient basis on which to make an investment decision. Before acting on any information in this document, you should consider whether it is appropriate for your particular circumstances and, if appropriate, seek professional advice. It is the responsibility of any persons wishing to make a purchase to inform themselves of and observe all applicable laws and regulations. Unauthorized reproduction or transmission of this material is strictly prohibited. Dimensional accepts no responsibility for loss arising from the use of the information contained herein.

This material is not directed at any person in any jurisdiction where the availability of this material is prohibited or would subject Dimensional or its products or services to any registration, licensing, or other such legal requirements within the jurisdiction.

"Dimensional" refers to the Dimensional separate but affiliated entities generally, rather than to one particular entity. These entities are Dimensional Fund Advisors LP, Dimensional Fund Advisors Ltd., Dimensional Ireland Limited, DFA Australia Limited, Dimensional Fund Advisors Canada ULC, Dimensional Fund Advisors Pte. Ltd., Dimensional Japan Ltd., and Dimensional Hong Kong Limited.

RISKS

Investments involve risks. The investment return and principal value of an investment may fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original value. Past performance is not a guarantee of future results. There is no guarantee strategies will be successful.

Diversification neither assures a profit nor guarantees against loss in a declining market.

UNITED STATES

Dimensional Fund Advisors LP is an investment advisor registered with the Securities and Exchange Commission.

Investment products: • Not FDIC Insured • Not Bank Guaranteed • May Lose Value
Dimensional Fund Advisors does not have any bank affiliates.

CANADA

These materials have been prepared by Dimensional Fund Advisors Canada ULC. The other Dimensional entities referenced herein are not registered resident investment fund managers or portfolio managers in Canada.

This material is not intended for Quebec residents.

Commissions, trailing commissions, management fees, and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Unless otherwise noted, any indicated total rates of return reflect the historical annual compounded total returns, including changes in share or unit value and reinvestment of all dividends or other distributions, and do not take into account sales, redemption, distribution, or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated.

AUSTRALIA

This material is issued by DFA Australia Limited (AFS License No. 238093, ABN 46 065 937 671). This material is provided for information only. No account has been taken of the objectives, financial situation or needs of any particular person. Accordingly, to the extent this material constitutes general financial product advice, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. Investors should also consider the Product Disclosure Statement (PDS) and the target market determination (TMD) that have been made for each financial product either issued or distributed by DFA Australia Limited prior to acquiring or continuing to hold any investment. Go to dimensional.com/funds to access a copy of the PDS or the relevant TMD. Any opinions expressed in this material reflect our judgement at the date of publication and are subject to change.

NEW ZEALAND

This material is issued by DFA Australia Limited (incorporated in Australia, AFS License No. 238093, ABN 46 065 937 671). This material is provided for information only. This material does not give any recommendation or opinion to acquire any financial product or any financial advice product, and is not financial advice to you or any other person. No account has been taken of the objectives, financial situation or needs of any particular person. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. Investors should also consider the Product Disclosure Statement (PDS) and for the Dimensional Wholesale Trusts the target market determination (TMD) that have been made for each financial product or financial advice product either issued or distributed by DFA Australia Limited prior to acquiring or continuing to hold any investment. Go to dimensional.com/funds to access a copy of the PDS or the relevant TMD. Any opinions expressed in this material reflect our judgement at the date of publication and are subject to change.

SINGAPORE

This material is deemed to be issued by Dimensional Fund Advisors Pte. Ltd. (UEN: 201210847M), which is regulated by the Monetary Authority of Singapore and holds a capital markets services license for fund management.

This advertisement has not been reviewed by the Monetary Authority of Singapore or the Central Provident Fund (CPF) Board.