

# Weekly CIO Letter

11 OCT  
2026

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## Higher rates are not hitting everyone the same

The Fed is tightening into an economy where AI investment and corporate profits remain powerful, while housing and household confidence absorb most of the pressure.

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# Executive Summary

The minutes of the Federal Reserve's September meeting clarified the policy message. All participants supported the 25-basis-point increase to a 3.75%–4.00% target range, and most judged that another increase would likely be appropriate by year-end. Inflation is still the constraint.

But the same minutes describe an economy in which monetary tightening is landing very unevenly. Business investment remains robust, credit is broadly available, corporate issuance is strong and AI-related capital spending continues to surprise on the upside. Housing, by contrast, is one of the few sectors the Fed explicitly identified as facing restrictive financial conditions.

That divergence widened this week. UBS expects global AI-related capital expenditure to rise from roughly \$900 billion in 2026 to \$1.2 trillion in 2027. J.P. Morgan Private Bank expects S&P 500 earnings to grow about 29% year over year in the third quarter, potentially extending the longest run of double-digit quarterly earnings growth since the post-financial-crisis rebound.

The household side looks different. Preliminary University of Michigan sentiment fell to 46.3 in October, current conditions dropped to 44.7 and one-year inflation expectations rose to 4.7%. The 30-year conforming mortgage rate was 7.43% on 7 October, up from 6.28% a year earlier. Higher rates are working—but mainly where households and rate-sensitive businesses need external financing.

| Fed target | 2027E AI capex | 3Q26E S&PEPS | UMich sentiment | 30Y mortgage |
|------------|----------------|--------------|-----------------|--------------|
| 3.75–4.00% | \$1.2tn        | +29% y/y     | 46.3            | 7.43%        |

Snapshot sources: Federal Reserve; UBS CIO; J.P. Morgan Private Bank / FactSet; University of Michigan; Optimal Blue / FRED. Observations are not from the same timestamp.

## CIO takeaway

The policy rate is restrictive, but the transmission mechanism is selective. The investment regime is being shaped less by one aggregate growth number and more by which sectors can fund themselves, pass through costs and convert capital spending into earnings.

# 1. The Fed is tightening — but transmission is uneven

The September FOMC minutes are unusually explicit about the split. Participants described economic activity as expanding at a solid pace and highlighted robust business investment, resilient consumer spending, narrow corporate credit spreads and strong loan and bond issuance. Yet they also singled out housing as a sector where financial conditions remain clearly restrictive.

AI sits at the center of that divergence. Several participants said the scale and pace of the AI buildout had continued to surprise on the upside. Some warned that AI investment could push aggregate demand ahead of aggregate supply, creating inflation pressure before the productivity benefits fully arrive.

That is why a higher policy rate does not have the same effect on every borrower. A household financing a home at more than 7% faces an immediate cash-flow constraint. A hyperscaler or infrastructure consortium with large internal cash generation, strategic financing access and secular demand can keep spending through the same rate environment.

UBS estimates that global AI-related capital expenditure will increase by more than one-third next year, from roughly \$900 billion in 2026 to \$1.2 trillion in 2027. The key macro point is not simply that AI is large. It is that a growing share of investment demand is becoming less sensitive to the policy rate than traditional housing, autos or small-business credit.

GLOBAL

## Global AI-related capex is still accelerating

Global AI-related capital expenditure, UBS forecasts, USD trillions

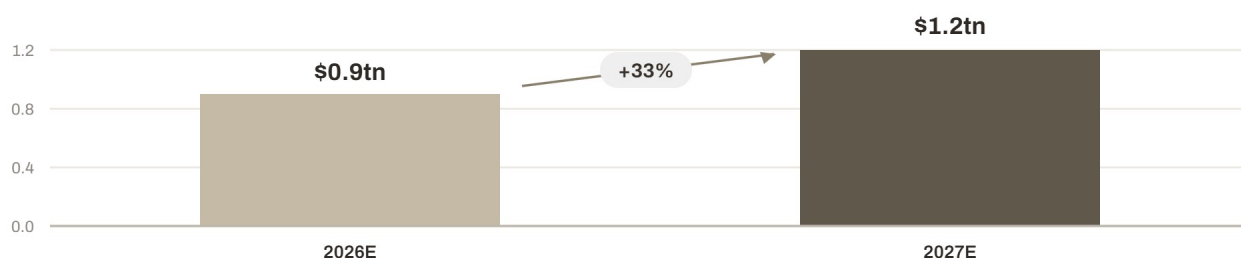


Figure 1. Source: UBS Chief Investment Office, 7 October 2026. Astro Wallenius reconstruction from published UBS forecasts.

## Why it matters

If rate-sensitive demand weakens while strategic capex remains strong, the Fed can cool parts of the economy without producing the broad demand destruction that usually accelerates disinflation.

## 2. Earnings are absorbing the rate shock

The equity market is not ignoring higher rates. It is being compensated for them by unusually strong profits. J.P. Morgan Private Bank estimates that S&P 500 earnings will grow about 29% year over year in the third quarter. If realized, that would mark eight consecutive quarters of double-digit growth—the longest streak since the rebound after the global financial crisis.

The quality of that growth is also improving. In the second quarter, S&P 500 earnings rose 52% year over year, or 34% after excluding selected

one-time gains. Net profit margins reached 17%, and third-quarter margins are expected near 15%, still comfortably above the five-year average of 12.6%.

More important for portfolio construction, earnings breadth is improving. The Magnificent 7 remain exceptional, but the rest of the index is catching up. For the fourth quarter, J.P. Morgan's published FactSet data show expected earnings growth of 27% for the remaining 493 companies versus 23% for the Magnificent 7.

UNITED STATES

### Earnings growth is broadening beyond the Magnificent 7

S&P 500 year-over-year earnings growth, %

■ Magnificent 7 ■ Remaining 493

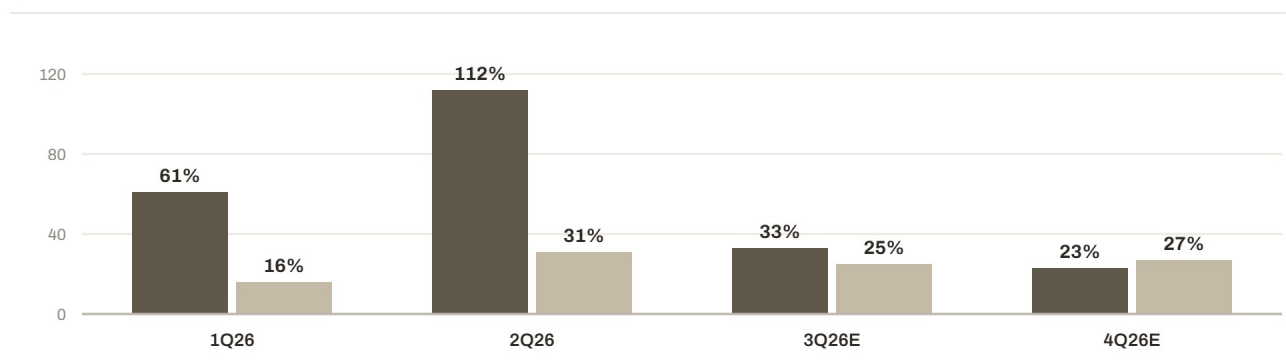


Figure 2. Source: J.P. Morgan Private Bank and FactSet, data as of 5 October 2026. Astro Wallenius reconstruction from published values.

This distinction matters because valuation pressure from higher yields is much easier to absorb when earnings estimates are rising. It also helps explain why the S&P 500 could return to record territory this week even as Treasury yields remained near multi-decade highs.

The global spillover is visible in the supply chain. UBS highlighted strong recent revenue and profit signals across Asian semiconductor and hardware manufacturers and continues to expect AI infrastructure spending to support semiconductors, power equipment, utilities and industrial suppliers beyond the U.S. mega-cap complex.

### 3. The household side looks very different

The same economy that is financing a historic technology buildout is producing near-record pessimism among consumers. Preliminary University of Michigan sentiment fell to 46.3 in October from 48.1 in September. The current-conditions index dropped to 44.7, while year-ahead inflation expectations rose to 4.7% and long-run expectations increased to 3.5%.

The composition is important. Michigan reported particularly sharp deterioration among lower-income households and consumers with smaller stock portfolios. The Fed minutes made a similar distinction: higher-income households have received support from rising equity wealth, while low- and moderate-income households are absorbing more of the burden from energy prices and the cost of living.

Housing provides the clearest example of monetary transmission. The 30-year conforming mortgage rate was 7.43% on 7 October, versus 6.28% a year earlier. That difference changes affordability immediately. It also discourages existing homeowners from moving when they are locked into cheaper legacy mortgages, suppressing transaction volumes and new construction incentives.

There is a second-order inflation problem. Apollo has highlighted a feedback loop in which higher rates reduce housing construction, weaker supply later puts upward pressure on rents, and shelter inflation then slows the return of overall inflation toward target. Monetary policy can therefore create disinflation through demand while simultaneously constraining the supply response in housing.

| Consumer sentiment          | Current conditions          | 1Y inflation exp.           | 30Y mortgage          |
|-----------------------------|-----------------------------|-----------------------------|-----------------------|
| <b>46.3</b><br>Oct. prelim. | <b>44.7</b><br>Oct. prelim. | <b>4.7%</b><br>Oct. prelim. | <b>7.43%</b><br>7 Oct |

Sources: University of Michigan Surveys of Consumers, preliminary October 2026; Optimal Blue Mortgage Market Indices via FRED.

## The policy dilemma

A central bank can raise the average price of credit, but it cannot decide which sectors are most sensitive to that price. Today, the heaviest adjustment is concentrated in housing and household demand—not in the strategic investment cycle.

## 4. Strong indexes do not mean broad risk appetite

The earnings picture is broadening faster than the market picture. Charles Schwab noted that major U.S. indexes were again challenging record highs this week, but participation beneath the surface remained unusually narrow.

Breadth has improved from the worst early-October readings. The

share of S&P 500 stocks above their 50-day moving average recovered from 19.7% to 31.0%, while the share above their 200-day moving average rose from 38.4% to 46.7% by 9 October. The rebound is constructive, but fewer than half of index members were still above their long-term trend line.

UNITED STATES

### Market breadth has improved — but remains narrow

Share of S&P 500 stocks above their moving average, %

Early-October low 9 Oct 2026

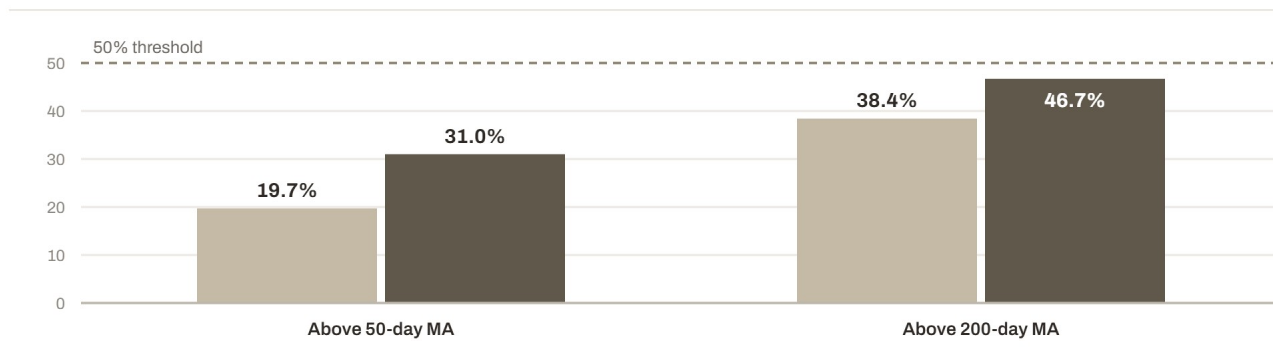


Figure 3. Source: Charles Schwab / Schwab Center for Financial Research, 9 October 2026. Astro Wallenius reconstruction from published breadth readings.

This creates a useful tension. J.P. Morgan's earnings data argue that profit growth is becoming less concentrated. Schwab's market-breadth data show that investor participation has not yet fully followed. If earnings breadth continues to improve, the market can broaden without requiring the largest technology companies to fail. If it does not, index-level resilience

will remain unusually dependent on a narrow group of winners.

For investors, that favors selectivity over simple beta. A company with durable cash flow, pricing power and a credible return on capital can justify a higher valuation even when discount rates are elevated. A long-duration story with weak free cash flow cannot rely on falling rates to repair the thesis.

### **What to watch next**

Third-quarter earnings guidance will test whether broader profit growth can close the gap between strong index performance and still-fragile market breadth. The 14 October U.S. CPI release will then determine whether the Fed has room to slow the tightening path.

# Portfolio Implications

## Equities

The strongest equity case remains in businesses that can translate the investment cycle into revenue, margins and free cash flow. AI exposure should be diversified across compute, semiconductors,

power, grid equipment, industrial automation and selected software rather than treated as a single mega-cap trade. Broadening earnings also argues for looking beyond the largest index weights.

## Fixed income

Higher yields are no longer merely a valuation headwind; they are an investable source of income. Apollo estimates that 84% of global fixed income now yields more than 3%, versus 12% in January 2022. We

continue to prefer high-quality short- and intermediate-duration exposure as the core, using long duration selectively where convexity justifies the term-premium risk.

## Global diversification

The AI capital cycle is global even when the demand originates in U.S. hyperscalers. Asian hardware and semiconductor supply chains, European industrials, power infrastructure and selected

emerging-market assets can participate through different revenue, currency and valuation channels. The objective is to diversify the source of earnings, not merely the listing venue.

## Liquidity and alternatives

Uneven monetary transmission increases dispersion. That raises the value of liquidity, private credit with strong covenant and recovery

protection, and strategies that can monetize relative-value differences rather than depend on one directional call on rates or equities.

# Astro Wallenius Perspective

The central message this week is not that monetary policy has stopped working. It is that the transmission mechanism has become more selective. Higher rates are clearly restraining housing, household confidence and other externally financed demand. At the same time, secular capital spending, strong corporate balance sheets and rising profits are keeping another part of the economy unusually resilient.

That is a difficult environment for macro shortcuts. Weak sentiment does not automatically imply weak earnings. Record equity indexes do

not mean broad financial conditions are easy. Higher policy rates do not guarantee lower investment when the projects being funded are strategic, capacity-constrained and expected to generate large future cash flows.

Portfolio construction should therefore be built around dispersion: income where yields are attractive, quality where refinancing matters, selective duration rather than indiscriminate duration, equity exposure tied to real earnings, and geographic diversification across the infrastructure and supply chains supporting the investment cycle.

## Selected sources

Federal Reserve, Minutes of the 15–16 September FOMC meeting, released 7 October 2026; UBS Chief Investment Office, 6–9 October 2026; J.P. Morgan Private Bank, “What risks? Earnings are up and to the right,” 9 October 2026; University of Michigan Surveys of Consumers, preliminary October results, 9 October 2026; Charles Schwab market commentary, 7–9 October 2026; Apollo Chief Economist, 4–9 October 2026; Optimal Blue Mortgage Market Indices via FRED, 7 October 2026.

## Glossary

**Capex:** capital expenditure. **EPS:** earnings per share. **Market breadth:** the share of securities participating in a market move. **Moving average:** average price over a defined lookback period. **Monetary transmission:** the process through which policy rates affect borrowing, demand, prices and activity. **Duration:** sensitivity of a bond price to interest-rate changes. **Convexity:** the non-linear change in bond price sensitivity as yields move.

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