

3RD QUARTER 2026 MARKET OVERVIEW

The AI trade dominates the stock market, but the question remains: will it continue to do so at the expense of the rest of the market?

Increasingly, the fuel supporting the stock market comes from a shifting cast of companies involved in the development and adoption of artificial intelligence. Nvidia, which commands a leading position in the essential chips that power AI, has become one of the world's most valuable companies, with a market capitalization approaching \$6 trillion. Meta, Microsoft, and their brethren have also helped propel the major market averages higher.

These generals of the AI revolution have almost single-handedly kept the broader market averages from turning negative. The S&P 500 gained 2.03% during the third quarter, while the Nasdaq advanced 2.47%. Meanwhile, the Dow Jones Industrial Average fell 2.70%. Beneath the surface, the picture was considerably worse. Approximately half of the stocks in the Russell 1000 declined during the quarter, and 20% of S&P 500 constituents suffered declines of more than 20%. In September alone, 80% of S&P 500 stocks fell.

The extraordinary spending on AI capabilities has created expectations for seemingly ever-increasing earnings among the companies participating in this technological revolution. This relentless bullish outlook continues to support their share prices, even as the broader economic landscape looks considerably less rosy.

Meanwhile, there are important forces that imperil the stock market. Inflation threatens to worsen, interest rates have risen to levels not seen in more than two decades, and the possibility of renewed warfare presents another potential disruption. Even some of the more preposterous concerns, including warnings that rogue AI agents might threaten our very existence, have entered the conversation.

So, there is trouble, even as the S&P 500 and Nasdaq hover near record highs. The conundrum is that while AI-related shares march relentlessly higher, much of the rest of the market flounders. Bonds have offered little refuge, as rising interest rates continue to undermine their value. Non-AI companies, particularly those perceived to be threatened by technology, face persistent selling pressure as investors abandon these businesses in favor of AI-related opportunities. This helps explain why so many familiar household names are trading near multiyear lows.

This tenuous relationship presents a balancing act for investors. Excessive exposure to AI-related equities introduces considerable volatility risk. At the same time, inadequate participation in this remarkable investment theme could produce disappointing returns.

THE GOOD GETS BETTER WHILE THE BAD GETS WORSE

"Individual stocks are the mother's milk of the stock market," as we like to say. Nowhere is this more evident than in the extraordinary performance of companies involved in the development and adoption of artificial intelligence. These stocks are not merely pulling away from the broader market. They are increasingly becoming the market itself.

...CONTINUED THE GOOD GETS BETTER WHILE THE BAD GETS WORSE

Consider the extraordinary concentration of stock market wealth. The broad American stock market is worth approximately \$78.5 trillion. Nvidia and a small group of other AI-related companies represent an estimated \$20 trillion in market value by themselves.

Think about that. A handful of companies account for roughly one-quarter of the value of the entire American stock market. Their influence over the market averages has become extraordinary. This concentration also provides a striking illustration of how stock market wealth can be redistributed. You may have heard the recent statistic showing that the wealthiest 0.1% of Americans have seen their collective fortunes double since 2019, from \$14 trillion to \$28 trillion. This small group controls roughly 15% of the nation's estimated \$186 trillion in total wealth.

But there is another equally compelling part of this story that receives considerably less attention: the membership of this exclusive group changes! New wealthy individuals arrive while others experience dramatic reversals in their fortunes. Consider two illustrious, homegrown Oregonians who founded their respective companies: Phil Knight of Nike and Jensen Huang of Nvidia. In 2019, Phil Knight's family stake in Nike was worth approximately \$31 billion, while Jensen Huang's Nvidia shares were worth \$1.25 billion. Today, Phil's Nike holdings have eroded to an estimated \$10 billion, while Jensen's Nvidia shares have grown to an astonishing \$209 billion.

For certain, the stock market has created a remarkable environment for wealth redistribution. Now consider this hypothetical. Had Phil Knight possessed the prescience to exchange his \$31 billion of Nike stock for Nvidia shares in 2019, that investment could, under the assumed appreciation, be worth an estimated \$6.479 trillion today! This would far eclipse Elon Musk's fortune, making Phil Knight the world's richest man.

PEREGRINE STRATEGY

Artificial intelligence continues to represent one of the most exciting areas of investment opportunity. Its influence on corporate spending, productivity, and the economy is likely to extend well beyond the present enthusiasm. For these reasons, AI-related companies currently form the core of our client equity investments.

Many stocks outside the leading technology companies remain entrenched in downtrends. Some may ultimately prove to be value traps rather than compelling investment opportunities. A depressed share price, by itself, is not a reason to invest. During the third quarter, we abandoned long-held positions in PepsiCo, GE, and Rocket Companies after their share prices failed to demonstrate sufficient stabilization. These sales reflect our unwillingness to remain indefinitely committed to investments whose prospects have become less attractive.

With interest rates having risen, fixed-income investments have also produced disappointing results during 2026. This is reminiscent of 2022, although not nearly as drastic. Until interest rates turn down, we believe there is reason to remain cautious about fixed-income investments. Cash is paying almost 4%. Additional Federal Reserve rate increases would improve the returns available on short-term cash investments.

We want to own investments with the potential for substantial appreciation. Ideally, every holding in our client accounts should be a viable candidate for a big move higher. It requires patience, but also a willingness to recognize when the prospects for an investment have changed.

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