Austin Cumblad
Relationship Manager,
Financial Intermediaries

The third quarter for the United States equity market resembled a duck. Above the surface, things were calm: the S&P 500 index rose 2% and was essentially flat in July and September. Below the surface, the quarter was far more turbulent: market leadership rotated sharply across styles, sectors, and market capitalizations as investors assessed the durability of artificial intelligence-related spending, the impact of higher oil prices, and the consequences of a more hawkish Fed.

Ultimately, the market's modest gain was driven by the simplest of factors: exceptionally strong corporate earnings and rising estimates for the year ahead. Robust fundamentals overcame the Fed's more hawkish stance, which culminated in its first interest rate increase since July 2023 and sent long-term Treasury yields to multi-decade highs. Economic growth also remained solid, supported by resilient consumer spending and business investment.

> Ultimately, the market's modest gain was driven by the simplest of factors: exceptionally strong corporate earnings and rising estimates for the year ahead.

Beyond earnings and rates, two other forces shaped the quarter. First, investors grew more discerning about AI. The market's question shifted from whether AI demand exists to whether the extraordinary level of investment will ultimately produce attractive returns. That concern was most visible in July, when semiconductor shares sold off sharply and memory stocks, among the strongest performers in the first half of the year, came under pressure. Second, geopolitical stress returned to the forefront as renewed conflict between the United States and Iran pushed oil prices higher, with Brent Crude briefly closing above $100 per barrel in September.

Those forces produced meaningful dispersion beneath the surface. Small-cap stocks, which had been a standout in the first half of the year, reversed sharply. The Russell 2000 fell more than 6% during the quarter and trailed the S&P 500 by more than 9%, its worst relative quarter since early 2020. The weakness reflected small caps' greater sensitivity to borrowing costs, as a larger share of Russell 2000 companies carry floating-rate debt. Growth and value also traded leadership during the quarter. Value stocks outperformed dramatically in July as higher yields pressured long-duration growth companies, but growth regained ground in August and September as investors bought the technology weakness and software shares continued their rebound.

Within the AI landscape, leadership also broadened. The first half of the year was dominated by chipmakers and memory-related companies tied directly to the AI infrastructure buildout. During the third quarter, investors placed greater emphasis on platforms, software, and companies positioned to use AI to improve productivity. Additionally, semiconductor and memory shares gave back a substantial portion of their gains, even as demand data improved. The quarter served as a reminder that expectations embedded in many AI-related stocks are high, and that even strong fundamentals can be vulnerable when valuations, interest rates, and capital spending assumptions are all being reconsidered simultaneously.

> The quarter served as a reminder that even strong fundamentals can be vulnerable when valuations, interest rates, and capital spending assumptions are all being reconsidered simultaneously.

Continued on next page.

Information in this newsletter is not intended to be used as investment advice. Mention of companies/stocks herein is for illustrative purposes only and should not be interpreted as investment advice or recommended securities. The securities identified do not represent all of the securities purchased, sold or recommended and the reader should not assume that any listed security was or will be profitable. Past performance is not indicative of future results.

Austin Cumblad
Relationship Manager,
Financial Intermediaries

Continued

Should equities advance in the fourth quarter, corporate earnings are likely to be the key catalyst, as they have been throughout 2026. Recently, earnings expectations have moved higher and profits have grown faster than stock prices, leaving broader market valuations at reasonable levels. History also offers support, as the final months of midterm election years have often been favorable for stocks once political uncertainty begins to fade.

> Corporate earnings are likely to be the key catalyst as they have been throughout 2026.

With that said, several factors could bring some of the underlying market turbulence to the surface. Interest rates will likely prove the most important variable. The Fed's next move and long-term yields could further weigh on valuations, particularly for smaller companies and faster-growing businesses. The conflict in the Middle East also remains unresolved, so it remains to be seen whether oil prices will provide a reprieve from or worsen inflationary pressures.

Finally, open questions about the durability of AI-related spending and an expected wave of large, high-profile public offerings could test investor enthusiasm.

A broadening market and increasing investor discernment are welcome developments and position the Riverbridge portfolios well heading into year end. Our holdings do not depend on capital spending cycles to compound their earnings, and many are already demonstrating that the application of AI enhances their strategic advantages. At Riverbridge, we remain focused on what we believe ultimately drives long-term success: investing in adaptable businesses capable of sustained earnings growth across a market cycle.

> We remain focused on what we believe ultimately drives long-term success: investing in adaptable businesses capable of sustained earnings growth across a market cycle.

Information in this newsletter is not intended to be used as investment advice. Mention of companies/stocks herein is for illustrative purposes only and should not be interpreted as investment advice or recommended securities. The securities identified do not represent all of the securities purchased, sold or recommended and the reader should not assume that any listed security was or will be profitable. Past performance is not indicative of future results.