



Market Matters: 3rd Quarter 2026

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“There's a lot of exuberance out there, so yeah, right now, it's good, but it was in '72, '86, 2000, 2007. That doesn't give me comfort.”

– Jamie Dimon, Bernstein Strategic Decisions Conference, May 2026

- **Energy shocks are raising inflation** — Oil above \$100/barrel, supply cuts of ~10M bbl./day, and cascading effects pushing global inflation up, forcing central banks to hold higher rates for longer.
- **Higher rates are compressing AI infrastructure returns** — While AI adoption is and will be strong, global infrastructure spending faces headwinds: elevated energy costs and a higher cost of capital, making concentrated mega-cap capex bets less attractive.
- **Mega-cap concentration is losing its edge** — Valuations that priced in lower rates and lower input costs are compressing.
- **Capital is rotating toward breadth** — Cyclical, energy, fixed income, emerging markets, and selective sectors offer genuine return opportunities.

When Costs Peak: Will An Energy Shock Help Broaden Returns?

Q4 2026 Investment Outlook

The cost of building the future just got more expensive.

Oil prices have surged above \$100 per barrel again in recent weeks, driven by escalating conflict and supply disruptions in the Strait of Hormuz—a waterway that carries ~35% of global seaborne crude. The term “supply shock” merits reframing: this is the largest oil supply disruption on record, cutting global supply by up to 10.1 million barrels per day (World Bank, 2026). The energy market is also signaling something more consequential about the structure of returns ahead.

Tightening energy markets reshape the investment landscape—and the shift, though uncomfortable for those overexposed to mega cap stocks, creates opportunity for the discerning investor. Inflation that persists long enough forces central banks to hold rates higher than markets anticipated. Higher rates, in turn, compress the returns on capital-intensive infrastructure, the very infrastructure that artificial intelligence requires. When that compression occurs, capital may flow elsewhere. Returns begin to broaden.

Energy Shocks, Inflation, and the Rates Ceiling

Global headline inflation is projected to reach around 4.7% in 2026, driven primarily by energy disruptions. The forecast is for G20 economies to average inflation around 4.1%. In the United States, the picture is acute. U.S. inflation could reach 4.2% by year end, well above earlier consensus expectations and among the highest rates in advanced economies.¹ This acceleration reverses the steady decline in inflation that had defined much of 2025.

The culprit in this case is easily identifiable. Energy prices are expected to jump 24% this year, marking their highest level since Russia's 2022 invasion of Ukraine. Brent crude was already 50% higher in mid-April than at the start of the year and is now forecast to average \$86 per barrel in 2026, up from \$69 in 2025.² This move filters through every supply chain around the world. When oil prices move this sharply, the impact isn't confined to the energy sector. Shipping costs rise. Fertilizers are becoming more expensive, projected to rise 31% this year. Transportation expenses rise across the economy, and food prices follow.

This same mechanism is familiar from the post-pandemic period, but the magnitude is different. Energy shocks aren't contained; they bleed into food inflation, manufacturing costs, and transportation. Some goods are affected more than others, but because almost everything travels, it ends up being touched by higher costs. For central banks watching these developments, the playbook is constrained by the broad and blunt instruments that they have available to tame inflation (i.e. interest rates). Treasury yields have reached multi-decade highs, with the 10 year over 5%.

This is where we stand now. Markets have already begun pricing in higher policy rates in both the Eurozone and the United States,³ reversing the modest easing cycle that began in 2025. The Federal Reserve, which initially signaled a more accommodative 2026, now confronts inflation data that militates against that message. Base rates that were expected to be lower by September 2026 remain elevated, and treasury yields have been creeping upwards. Tech stocks are long-duration assets because their valuations depend on cash flows that stretch far into the future. Higher yields raise the discount rate with which these are priced, lowering the present value of their profits and putting downward pressure on valuations.

The AI Infrastructure: Capital Intensity Meets Higher Costs

Artificial intelligence has entered a full-scale infrastructure build-out phase. Global AI infrastructure spending is projected to reach \$1.48 trillion in 2026, with total AI spending reaching \$2.67 trillion, and infrastructure now represents more than half of all AI expenditure. This figure encompasses the full range of infrastructure investments: cloud platforms, AI-optimized servers, networking, processors, and devices. Within this, hardware capex specifically—data center systems, accelerated servers, and related physical infrastructure—represents roughly \$500 billion, constituting a pressure point from energy and construction costs.⁴ For context, the last time capital

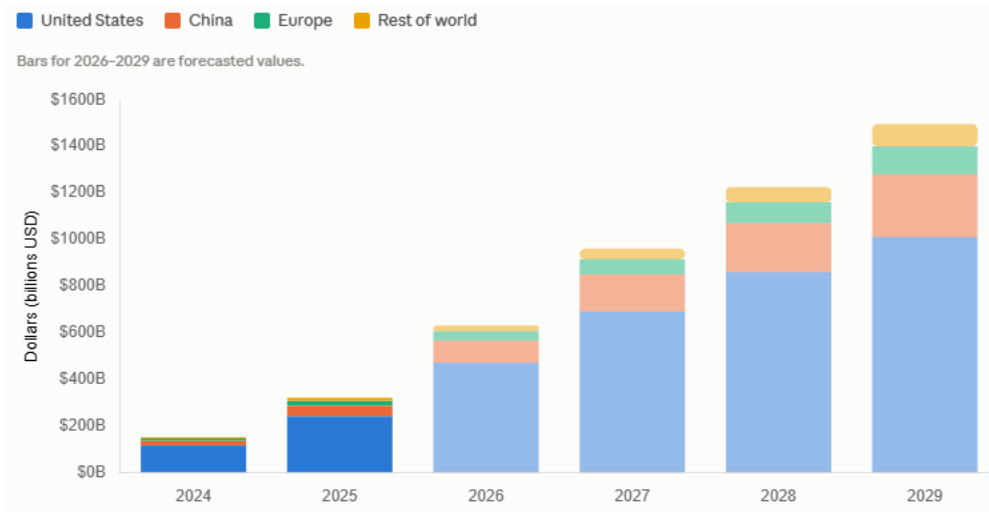
¹ International Monetary Fund, OECD.

² World Bank.

³ Eurostat.

⁴ Gartner, IDC.

flowed at this intensity toward a single technology cycle was during the cloud computing and telecommunications buildouts of prior decades. This is a reallocation of the world's investable capital toward a specific set of outcomes.



Global AI Infrastructure Spending by Region, 2024–2029

Infrastructure—particularly data center infrastructure—requires electricity, cooling, physical space, physical materials, and increasingly sophisticated power management. When energy prices rise, and when central banks respond by raising rates, the arithmetic of these projects becomes less forgiving. The basic materials used for these projects, including steel, concrete, specialized flooring, insulation, and more have become more expensive because of inflation. Electricity prices face upward pressure. Then, when monetary policy responds the cost of capital becomes more expensive as well.

Table 1: Worldwide AI Spending by Market, 2025-2027 (Millions of U.S. Dollars)

Market	2025	2026	2027
AI Services	434,046	576,481	745,655
AI Cybersecurity	25,920	51,347	85,997
AI Software	288,168	461,637	656,353
AI Agents and Assistants	16,481	29,219	65,472
Generative AI Models	13,021	28,266	51,620
AI Platforms for Data Science and Machine Learning	19,405	26,445	35,552
AI Application Development Platforms	6,885	9,541	12,478
AI Data	826	3,126	6,480
AI Infrastructure	981,920	1,484,397	1,977,685
Total AI Spending	1,786,671	2,670,460	3,637,292

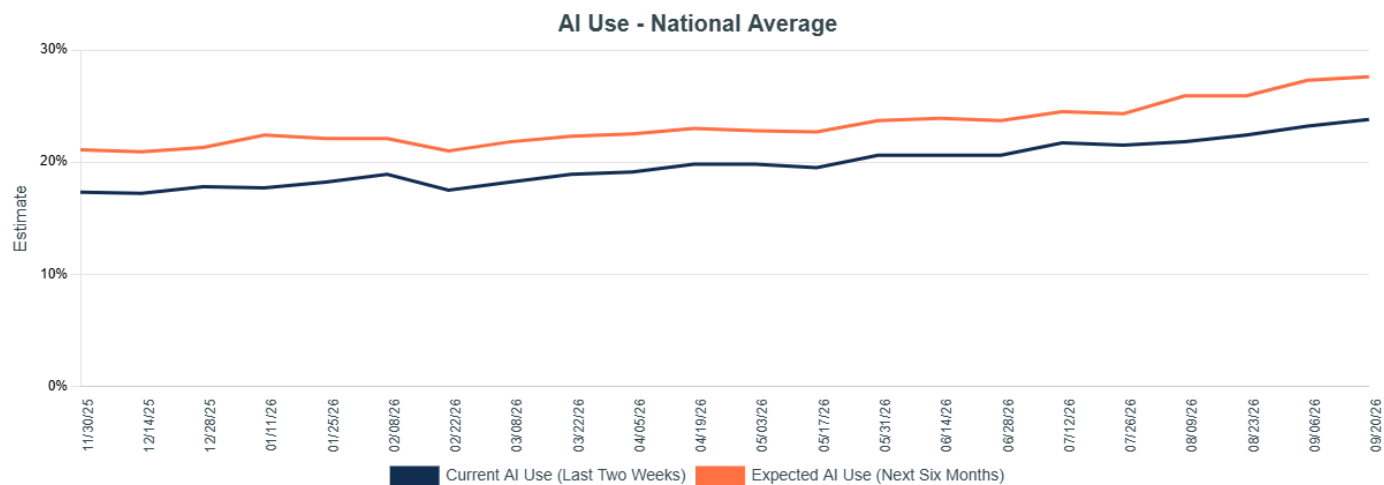
Source: Gartner (September 2026)

deployed. One way to achieve those higher returns is to build bigger, deploy faster, and capture functionality and market share before competitors do—which has driven capex up. But in a world where capital itself has become more expensive, that is no longer a winning proposition.

Consider the math: a data center expansion that made sense at a 3% cost of capital and \$70 per barrel oil looks materially different at a 5% cost of capital and \$100 per barrel oil. The compressed returns are not dramatic enough to cancel projects, but they are real for future investment decisions. Investors funding these infrastructure ventures need higher returns to justify the capital

The market has sensed tension. There has been heightened volatility in technology stocks, driven not by fundamental deterioration but by the realization that valuations priced in lower rates and input costs.⁵ The narrative has shifted from "AI will drive returns" to "which AI bets actually make sense at these interest rates?". More speculative bets have become unfavorable while companies with strong earnings, strong balance sheets, and early AI monetization have fared better. Sixty percent of stocks in the Nasdaq 100 are in individual bear markets.

This is not a reason to abandon artificial intelligence as an investment theme. Adoption of AI into production processes continues. Over 23% of businesses are actively using AI and more expect to roll out usage in the next 6 months. The fast pace of AI adoption a defining development. Global usage rose approximately 250% in the first quarter of 2026 alone, measured in units/tokens.⁶ The structural case for AI remains intact. But the concentrated bet on the few companies at the forefront of capex spending becomes stretched relative to the actual earnings power of those businesses at a higher cost of capital.⁷



The Broadening: Where Capital Flows When Mega-Cap Returns Compress

When mega-cap infrastructure faces dual headwinds—higher rates and higher energy costs—capital doesn't disappear from the market. It rotates. And in the current environment, rotation looks to have begun. The Russell 1000 Value has outpaced its growth counterpart by 12% year-to-date on a compounded basis.

Cyclicals and value typically capture energy exposure. The traditional bearish case for energy and energy-related stocks has rested on the assumption of

Russell 1000 Value vs Growth Monthly Total Returns			
Month	Value	Growth	Spread
January	4.5%	-1.6%	6.1%
February	2.6%	-3.4%	6.0%
March	-4.9%	-5.0%	0.1%
April	8.2%	11.9%	-3.7%
May	2.9%	7.2%	-4.3%
June	2.2%	-2.8%	5.0%
July	3.9%	-4.7%	8.6%
August	1.7%	4.4%	-2.7%
September	-3.2%	2.2%	-5.4%
YTD 2026	19.2%	7.1%	12.1%

⁵ Federal Reserve.
⁶ Morgan Stanley.
⁷ Chart below from Census.gov

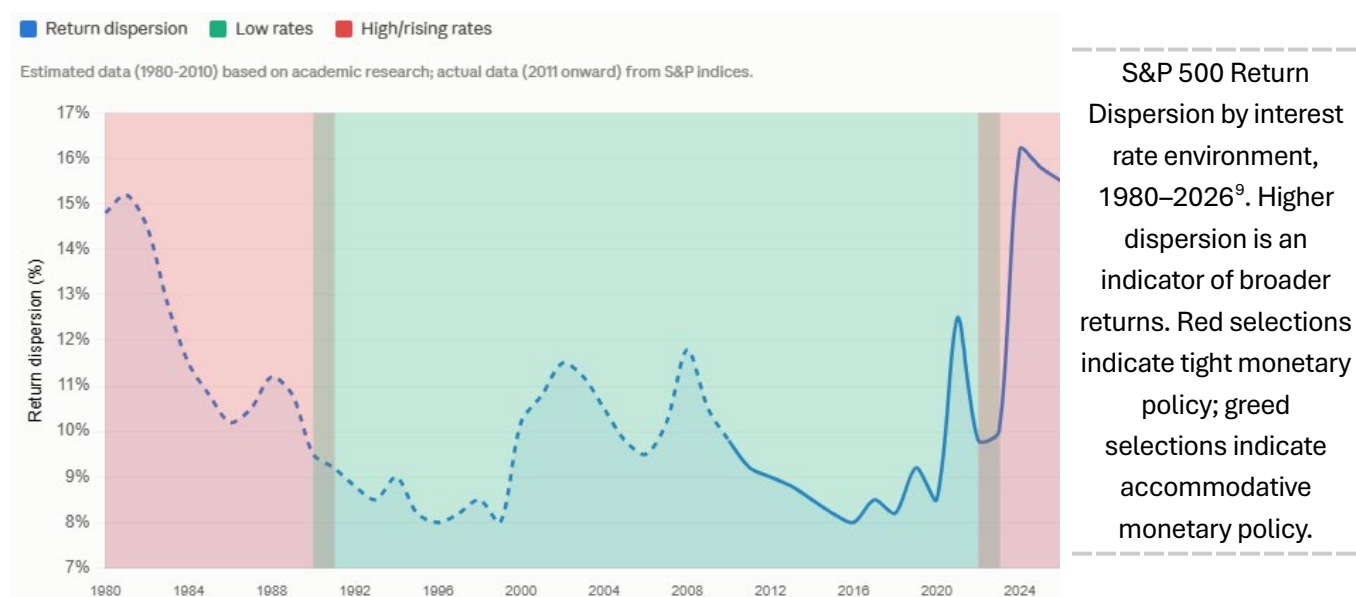
perpetually lower energy prices. That case has fractured. If oil remains in the \$80+ per barrel range over the coming quarters, then companies with direct exposure to energy prices, such as integrated oil producers, industrial suppliers, and transportation have visibility to higher cash flows. These sectors have lagged over the past two years as capital poured into mega-cap tech. A broadening return environment favors mean reversion.

Fixed income is no longer purely defensive. Fixed income has been viewed primarily as a portfolio ballast—something you hold to reduce volatility, not to drive returns. That calculus has changed. Spreads have widened modestly, and with some global real policy rates now positive and credit spreads offering genuine compensation for risk, fixed income is emerging as a meaningful driver of total returns rather than merely a defensive hedge.⁸ For investors managing spending from portfolios, this is significant. It opens the door to variations of traditional allocations that capture return without requiring outsized equity risk.

Emerging markets and commodities offer upside optionality. Most emerging market economies have been pressured by a strong U.S. dollar and slower growth in China. But select EM economies are also a primary beneficiary of higher commodity prices. Many export oil and/or metals, a critical part of infrastructure development. If energy prices remain elevated and broad-based commodities strengthen, emerging market terms of trade improve.

Selective sectors like healthcare, industrials, and select consumer staples have performed reasonably well in a higher-rate environment, particularly when weighted toward companies with pricing power. These sectors lack the capital intensity of Mega cap technology, which means they are relatively less vulnerable to rate shocks. A rotation from concentration (including primary indices) in a handful of mega-cap names toward a more diversified basket across sectors and geographies reduces tail risk while capturing returns from the broadening cycle.

The broadening is not a call to abandon growth or technology. It's a call for selectivity. The best-positioned AI companies (those with demonstrated cash generation and reasonable valuations) will still drive outperformance. But they will no longer be the only game in town.



⁸ Morgan Stanley.

⁹ Select charts in this memo were produced with the assistance of Claude.ai

Timing the Transition: Portfolio Construction

The energy shock is reshaping the return environment in ways that are beginning to price through markets. For portfolios that held concentrated positions betting on perpetual mega-cap technology dominance, this will feel uncomfortable. For diversified, rebalanced portfolios, this is an invitation to broaden the market.

The transition from concentration to broad based returns rarely announces itself. It doesn't arrive neatly, with a clear inflection date and universal market agreement. It may occur in waves, with each data point on inflation and each central bank comment recalibrating expectations. The energy shock of September 2026 is providing that catalyst now.

The portfolios best positioned for the next twelve months are not those making binary bets on whether AI "works"—it obviously does. They are portfolios disciplined enough to capture the broadening returns that follow. The infrastructure build-out will continue. But the returns on that capital will be earned by those patient enough to wait for reasonable entry points, and thoughtful enough to diversify sources of returns. The cost of building the future got more expensive, and the market is responding to those consequences.

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