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EPISODE 48

Looking for the Negatives Even as Earnings Boom

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September 13, 2026

S&P 500 operating profits reached a record $853 billion in 2Q 2026. And we expect new records for corporate profits in the coming year.

Yet, rather than reach new highs, US and global shares have deflated more than 2% over the past month. The drop is technically insignificant so far. But the forces behind the move are notable and are potentially worsening risks to the economic outlook.

The Iran War continues to drive higher oil prices. Inflation remains above target. The Fed is expected to raise rates. And the absence of more good news on the corporate front leaves a vacuum of positives.

For tactical investors, a pullback in equities can be an advantage. For myopic investors, a drop could cause one to make strategic blunders.

On Monday, August 31, CIO Group modestly reduced its global equities allocation in favor of short-term debt securities. The particular asset we chose – floating rate obligations with near-zero duration – yield about 4.9%. Our favored implementation strategy in the broader short-duration universe yields about 5.7%. Yet we should be clear: Equity market pullbacks in both early 2025 and 2026 were buying opportunities we took advantage of. We are likely to do so again.

Fake News: Lowering the Bar

Analysts estimate significantly slower annualized EPS growth between 2Q and 3Q '26 (see figure 1). The sharp drop in expected EPS growth (from 34% to 24%) is dubious. Guiding to lower growth allows the mass preponderance of public companies covered by Wall Street to easily "beat" these reduced estimates. In contrast, the longer-term EPS forecasts of the analysts show an upward rather than downward bias. This makes street "estimates" suspect and sometimes nonsense in our view.

Looking more deeply, the Financial and Energy sectors show unusually low expectations for Q3 and we would expect resounding "beats." There are likely to be other industries that do the same.

Yet only companies that have material negative information are generally obligated to "pre-announce." This may mean further estimate cuts before reporting in October/November. Therefore, in the absence of "good news" pre-announcements create a negative news bias.

Furthermore, many firms refrain from making share re-purchases ahead of earnings reports to avoid claims of market manipulation. This alone can change the equity market "tone" ahead of earnings.

FIGURE 1

S&P 500 vs EPS and Analyst Estimates

SOURCE: CIO GROUP, HAVER ANALYTICS, BLOOMBERG

Rate Hike or Relief? Here Comes the Fed

This coming week, the Fed is expected to begin a modest new tightening cycle (please see last week's Point for full discussion). After the European Central Bank pushed its key policy rate from 2.25% to 2.50%, US markets became even more confident that the US would do the same (see figure 2). With deliberate ambiguity as Warsh's policy, global markets are sure to move on the Fed's action, even though markets are 70% certain of a hike.

FIGURE 2

Fed Funds Futures Implied Probability of 25 Basis Point Rate Hike at FOMC Meeting

SOURCE: CIO GROUP, HAVER ANALYTICS

Higher Oil Prices Due to Low Oil Inventories and More War

In our Point Broadcast this past week, we focused on the extended conflict in Iran and dwindling strategic oil reserves (see figure 3).

While President Trump predicted “the war is going to end immediately after the (US midterm) election because they can’t hold out any longer,” former presidential advisor Thomas Wright suggested that Iran can readily hold out much longer than rational actors would. Autumn in the Northern Hemisphere provides a very short window of easing demand pressures, yet the fundamental disruptions to wider Middle East oil and gas exports have caused crude oil to hit $109 briefly again.

With central bankers ignoring the fact that higher inflation is due to external shocks, a regime shift has occurred in the bond market this year. Higher yields and oil prices are now closely correlated (see figure 4). This means interest rates and energy costs may jointly increase pressure on US households.

FIGURE 3

OECD Crude Oil Inventories (Strategic Reserves and Commercial)

SOURCE: CIO GROUP, HAVER ANALYTICS, BLOOMBERG

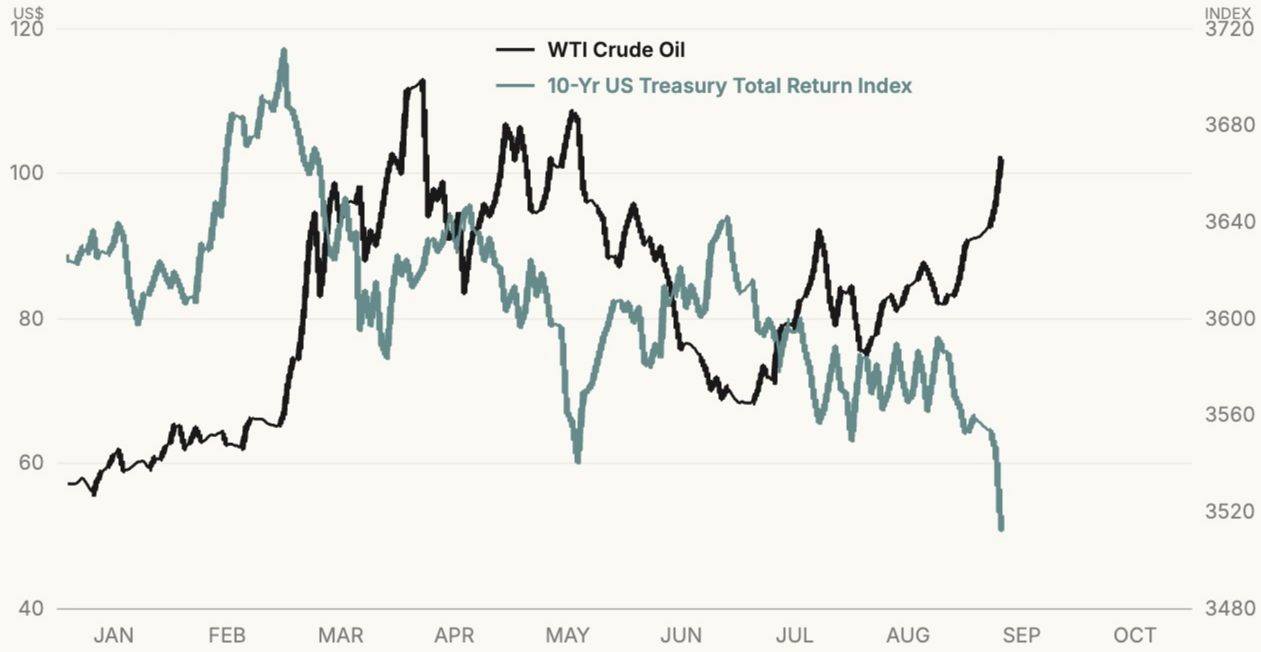
Oil, Oil Everywhere but Not Enough in Tanks

The world has adapted remarkably to a record supply disruption in part by an unsustainable drawdown of strategic reserves. While the Straits of Hormuz are unlikely to allow Gulf Country exports to achieve prior levels, alternative Saudi export routes and new routes from the UAE and others will lower the strategic importance of the Straits over time. This may even become a catalyst for a negotiated settlement of hostilities. Therefore, we do not think higher sustained oil prices are a certainty.

That said, we are not lowering our investment allocations to “supply chain diversifiers” such as US export terminals and energy asset gatherers. Similarly, despite wobbles, we believe a bull market in defense deterrents is unfortunately a new and lasting fixture of the global outlook.

FIGURE 4

US Treasury 10-Year Total Return Index and WTI Crude Oil Price



SOURCE: CIO GROUP, HAVER ANALYTICS, BLOOMBERG

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