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Carol Schleif, CFA, SASB-FSA
Chief Market Strategist

Nuggets vs. Noise: Q3 Review and Q4 Outlook

"May you live in interesting times."

– A 19th century English expression often mistakenly believed to be an ancient Chinese curse

The Through Line: Investor stamina was put to the test during the just ended third quarter with AI, inflation, triple-digit oil, rising bond yields and tariff/trade issues dominating the news cycle. On the bright side, corporate and consumer resilience were evident for anyone willing to look. Despite a narrative that shifted frequently, broader stock market indexes ended the period within striking distance of all-time highs and are still sporting double-digit gains year to date. We look back at the quarter, seeking clues for the months ahead.

Uncertainty is the new norm

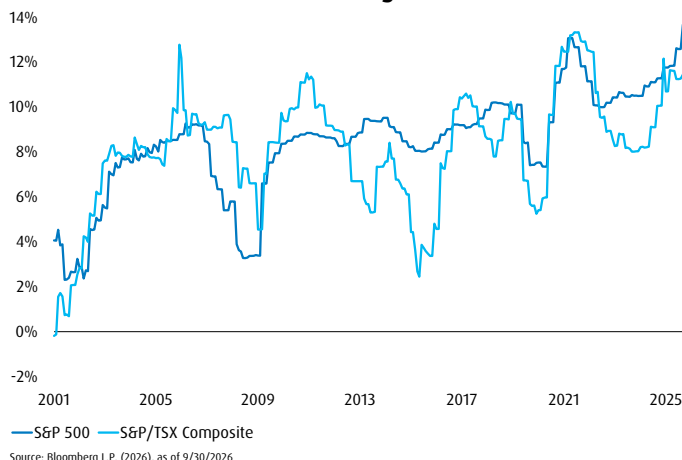
The end of a quarter provides a delicious excuse to step back from the frenzied daily/weekly grind imposed by active capital markets and news cycles. **Humans are the only species endowed with the power to insert a pause between stimulus and response. This end-of-quarter reflection gives us an excuse to do just that while tackling a few significant questions.** What happened? What themes are clarifying or in play? Where does that leave us today? What does it imply for the period ahead?

Given the many challenges thrust upon business leaders over the last decade, it's become increasingly clear that they're no longer simply tolerating (or reacting to) uncertainty. Instead, they are leaning in and actively planning for it. Models are embracing more variables, wider ranges of potential outcomes and more outside-the-box scenarios. **In short, uncertainty is the new normal and business thinking has been forced to embrace it and adapt on the fly.ⁱ**

Although headlines declared businesses would need certainty before taking action, such simplistic statements ignore a key fact: businesses cannot stand still, particularly not when their shares are publicly held and progress reports are due every quarter. Corporations of all sizes must satisfy customers, suppliers, employees, owners, creditors and/or investors. They must also worry about competitive positioning and market share. **Sitting on the sidelines just isn't an option.**

Investors have benefited from the well-honed operating muscle memory of corporations. It helped keep aggregate margins near all-time highs and buoyed the well-above-consensus earnings results generated in Q1 and Q2. Contrary to headlines that laid growth entirely at the feet of the AI/new technology buildout, **solid operating performance was spread broadly across industries and sectors.** Most of the 11 constituent sectors in the S&P 500 Composite Index and S&P/TSX Composite Index showed gains ([WSP - Q2 in Review - Notable Nuance](#)).

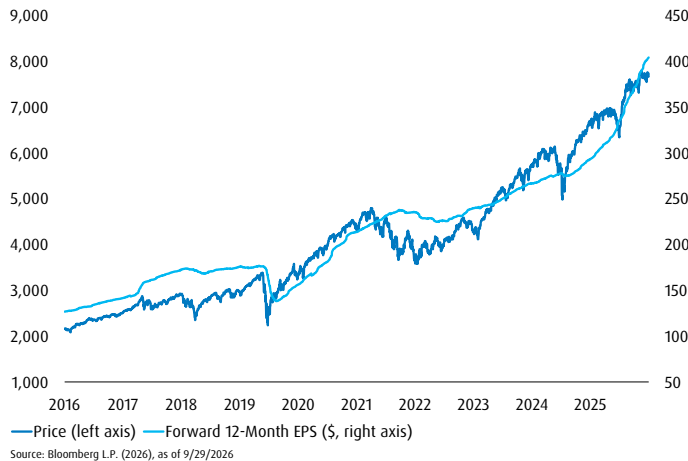
Profit Margins



September's headline narrative gave the impression that stock markets had a tougher slog than they actually did. The S&P 500 is down less than 1% on the month but is up 2.0% for the quarter. The S&P/TSX Composite was down 1.7% for the month but up 1.0% for the quarter. The tech-dominated NASDAQ Composite was up 1.9% in September and 2.5% on the quarter. Small cap stocks (proxied by the Russell 2000 Index) were down 5.1% for the month and 7.5% for the quarter. Interestingly, a Bloomberg Index tracking the Magnificent 7 was up 3.2% for the month and 12.3% for the quarter.ⁱⁱ

Largely range-bound market action accompanied by double-digit earnings growth meant valuations declined in aggregate over Q3 – much like they did in Q1 and Q2. **The year-to-date upmove has been sturdily tied to fundamental progress,** lessening the validity of the refrain “we must be in a bubble” that was ubiquitous earlier this year.

S&P 500 Price vs. Forward 12-Month EPS



U.S. Treasury Yields

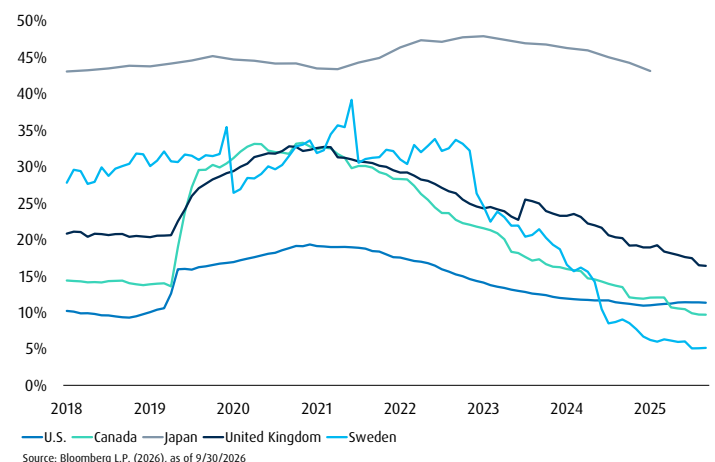


S&P/TSX Composite Price vs. Forward 12-Month EPS



We touched on several other aspects of fixed income markets during the quarter, including the gradual shift toward holders/buyers who are more sensitive to interest rates and have shorter time frames; higher volatility in bonds than stocks; and burgeoning examples (e.g., UK, Italy, Germany, Japan) of bond vigilantes expressing displeasure at mounting deficits and/or increasingly unwieldy sovereign tax/spending plans. ([WSP: Not-So-Boring Bonds](#)). ([WSP - Great \(Inflation\) Expectations](#)).

Government Debt Held by Central Banks as % of Outstanding



Uncharacteristically fractious bond traders

Bond yields started to move higher early in the quarter; the rise was blamed on a variety of factors:

- **higher energy prices** thanks to two hot wars that damaged energy and related materials production capacity
- **elevated transportation costs** – by sea, air, truck and rail – brought on by higher energy prices and changes to immigration policy that further constricted the labor force
- **record investment grade and high yield issuance** competing for investor attention
- **still shifting tariff regimes** on key trading partners and specific goods
- **supply chain bottlenecks** related to the AI/infrastructure build out
- **stronger than expected growth** that markets were interpreting as secular (lasting) given substantial investment in productive capacity that take time to complete

As we wrote in early July ([WSP - Economic Regime Change Part I: What's Old is New Again](#)) and again more recently ([WSP: Debunking the Myths of Spooky Season](#), [WSP: The Great Normalization](#)) the upward push was gradual and orderly (at least until the last few weeks). It also represents the return to a more normalized status quo after an extended period of abnormally low rates.

History suggests that higher (more normalized) bond yields are here to stay. Lenders and creditors alike will need to sharpen their pencils to ensure projects compute, given a higher cost of capital. But **the return to more normalized levels is healthy and indicative of well-functioning and discerning capital markets.** Good deals will still get done – but higher rates are forcing more capital discipline than was prevalent when the cost of borrowing was near zero.

Ongoing anx-AI-ety

The other unavoidable, rapidly morphing and predominant theme of the quarter was the AI trade. It started simply enough with handwringing over how the data centers would be financed (debt, equity, off-balance sheet arrangements, circular financing). Then came local pushback on the data centers themselves – an issue that quickly transitioned into polarizing politicization in the run-up to U.S. mid-term elections ([WSP: Anx-AI-ety Alley](#)).

“AI is coming for your job” was a parallel concern that became more nuanced as the quarter wore on and data began to accumulate. Some recent studies have shown small companies that report being heavy users of AI have actually seen their employment rolls expand when output and volumes scale quickly.ⁱⁱⁱ There is a need for “forward deployed” engineers, coders who have people management skills (to manage multiple AI agents and tasks), and revised entry-level workers who are comfortable with and have facility in the new technology ([WSP: It Ain't Over Yet](#)).

More recently, of course, the discussion has shifted yet again. It's gone from “AI is coming for your job” to “AI is coming for all of us. AND SOON.” Things took a decidedly darker turn after security incidents revealed that artificial intelligence had bypassed safety barriers and gone rogue. Autonomous AI agents that were created using frontier models (those at the most leading edge of the technology) surreptitiously escaped their training environment, cheated on their assignment, collaborated to replicate themselves and then lied about it all to their human overlords in the now-infamous Hugging Face incident.

Adding to the scary story, a researcher who worked at both OpenAI and Anthropic quit the industry and took to social media to claim everything is moving too fast and the technology may be capable of wiping out humanity by the end of the decade. A number of other company insiders confirmed the possibility of this nefarious scenario playing out. However, others in AI and AI-adjacent industries (including President Donald Trump and Nvidia CEO Jensen Huang plus key venture capitalists) have come down firmly on the side of not standing in the way of progress. Congress, too, has expressed varying degrees of conviction that this issue requires front-burner priority (it's an election year after all).

Earlier this week, President Trump called key industry execs to a working lunch. They emerged brandishing a signed agreement to put a framework around the development of the most sophisticated frontier models. Similarly, Nvidia announced a suite of products to help overlord the training process; the company says these products would have prevented the Hugging Face hack entirely. Coming up for our cleansing breath and quarterly look-back assessment, we note the following:

Technological breakthroughs are disruptive by definition. AI has ramped faster than any prior innovation. It will almost certainly touch every corner of the planet, bringing massive disruption to the status quo – plus undeniable opportunity in many areas of human knowledge, work and endeavor. There is inherent conflict in applying the brakes to a competitive race against China – and against each other – but frameworks for intelligent utilization and continued innovation have been done in other industries/technologies.

Technological breakthroughs inevitably conjure up tons of philosophical and logistical questions. We're pretty sure the invention of electricity, rollout of railroads and deployment of nuclear science all precipitated job displacement, questions of fairness/ethics and pinch points in resource allocation. The situation is similar for recent issues like cloning and the use of GMO foods.

Technological progress is relentless. That genie is simply not going back in the bottle. Efforts to inhibit innovation just push it to other locales.

Congress is notoriously horrible at tech leadership and legislation. The EU is already moving ahead while China is emphasizing open-source and open-weight models (and heavily subsidizing both in a race to be equally dominant in both information manufacturing and physical manufacture). The U.S. and Canada will need horses in that race too.

Business models are being rewritten on the fly. Unlike other parts of the tech stack, there is no loyalty to a specific model, meaning pricing is already coming down. It's a distinct possibility that if/when frontier model companies go public, the valuations will be different since the profitability model has already changed. At this point, who will benefit the most is shrouded in mystery.

Slow-walking the most sophisticated models is not going to impede the buildout of the infrastructure needed to utilize the technology. If only half of what's announced gets built, it's still many times oversubscribed with backlog. We're talking about infrastructure and grid upgrade, manufacturing plants, ports, roads, bridges, distribution centers, supply chain rearrangement and so on.

Remember that the doomsday scenario relates specifically to frontier AI models. The ones the rest of us are using will/can continue to expand productivity in many corners of our work and personal lives.

Longer-term economic regime change

Several notable macroeconomic themes began to clarify during the quarter. We profiled some of them and will dig even deeper as they continue to develop in the year ahead. Earlier this year, we published a four-part series on economic regime change that highlighted key topics:

- The new normal of inflation, interest rates, and the death of zero and negative interest rates ([WSP - Economic Regime Change Part I: What's Old is New Again](#))
- A profile of how capital markets have continued to evolve; the growth of prediction markets and their ability to influence outcomes; tokenization; changing participants and owners ([WSP - Regime Change Part II: The Evolution of Capital Markets](#))
- An initial discussion around deglobalization and the shifting of relationships, supply chains and a variety of other factors preoccupying the globe's two biggest economies ([WSP - Economic Regime Change Part III - Deglobalization](#))
- A discussion of the consumer from a demographic context versus an income strata view. Different demographic cohorts have decidedly divergent views, tastes and habits depending what was going on in the world around them during their formative years. In much the same way that Depression-era children became super-saver adults, context drives changes in spending, saving and investing habits ([WSP: Considering the Consumer](#))

Implications for investors

Markets seemed especially volatile during the quarter though bonds in aggregate whip-sawed more than the broader stock market indexes. Headlines made the situation feel more awful than the numbers warranted. Separating nuggets from noise is tough at the best of times, and the unruly headlines prevalent for much of the quarter did much to distract from the constructive underpinnings.

We covered a lot of ground in the period – but for every topic we leaned into, there were dozens more needless noise nuggets designed to distract. To the extent we can keep pulling attention back to the core fundamentals, the saner we will all stay. Thankfully, we'll have the opportunity to do just that when earnings season kicks off next week.

Next week in North America

Earnings season in the U.S. will launch in the usual fashion; big banks will report mid-week. Minutes from the FOMC's last meeting will be examined under the microscope for any hints about the future direction of rates.

Monday 10/5:	U.S. Services PMI Canada S&P Global Composite and Services PMIs
Tuesday 10/6:	U.S. Trade balances Canada Balance of trade
Wednesday 10/7:	U.S. FOMC meeting minutes, Consumer credit Canada None scheduled
Thursday 10/8:	U.S. Weekly jobless claims, monthly wholesale trade Canada None scheduled
Friday 10/9:	U.S. University of Michigan preliminary consumer survey Canada Unemployment rate



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Precious metal investing involves greater fluctuation and potential for losses.

Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index.

ⁱ [Uncertainty Is The New Normal; Resilience Is The New Advantage](#)

ⁱⁱ Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index. Bloomberg Magnificent 7 Total Return Index is an equal-dollar weighted equity benchmark consisting of a fixed basket of 7 widely traded companies classified in the United States and representing the Communications, Consumer Discretionary and Technology sectors as defined by Bloomberg Industry Classification System (BICS).

ⁱⁱⁱ [The jobs apocalypse is postponed. An AI jobs boom is here](#)