MILLER TABAK + CO., LLC

11, October , 2026

BOTTOM LINE: Despite worsening credit signals (HYG), weakness in small caps, and persistent macro/rate headwinds, equities are being buoyed by strong Q3 corporate earnings growth, noteworthy strength this week across the entire spectrum of financial stocks and early strength in key retail names ahead of the holiday season. Meanwhile, high mortgage rates and rising credit default swaps present noteworthy ongoing risks, though oversold technical indicators in the bond market suggest a potential near-term stabilization in government yields.

1) For the last two Sundays, I have expressed my deep concern and confusion as to how the S+P 500 could continue to march forward in the face of the worsening performance of my most important indicator—HYG. This etf has historically served as a useful risk-appetite and credit-condition indicator and has an excellent record of portending moves in both directions for the S+P. HYG is still flashing significant warning signs for equities although it did close slightly higher on the week. Nevertheless, we have now witnessed 5 weeks in a row of a lower high in the face of higher yields in the junk market, and the investment grade market as well (although less so) beginning late in August. The only rational explanation for this stressful juxtaposition as stated last week is that investors are mesmerized by the growth in corporate earnings and the guidance provided by companies.

2) Indeed, a preview of this upcoming earnings season underscores the point just expostulated. All 11 S+P sectors for the 3rd quarter are expected to show y/y growth for the first time since 2021 with that percentage being somewhere between 15-18%. Moreover, using the current Street earnings estimates for 2027, the multiple on the S+P cascades to 18.5x vs. the 22x projected for year-end '26 earnings. One must also note the performance of the financial stocks this week, which has been dreadful for most of the summer, has been fundamentally based on higher yields. There was strength in this group across all sub-sectors this week. JPM, having established lows in the $325-$326 range three times between late June and late September, "tested" that level again this week and closed smartly higher. APO had a strong end-of-week rally although the stock has had 5 weeks in a row of lower highs. APO also announced on Wednesday that it would lead the financing effort of SPCX's $40Bb issue to buy NVDA's chips. Have investors finally begun to accept the unrelenting positive guidance from

private equity managements is outweighing the difficulty of these companies extricating themselves from deals of 5 or 6 years ago as well as the unending redemptions and negative views on gating? V, another subsector of the financials bounced 10 points on Friday to close at a new all-time high and CRCL/HOOD also had impressive end-of-the week performances.

3) The bears will instead focus on the poor action of the small cap stocks believing the market cannot sustain a further upward thrust with just the "generals." While the Russell this week did take out the previous week's high, the Index still has had 6 weeks in a row of lower highs. I stated the fundamental case for the poor performance of the Russell last Sunday so I won't repeat myself. Bears are also honed in on the rising CDS levels in a number of marquee tech names. The poster-child is ORCL where the CDS this week soared to 256; several of the hyperscalers also remain stubbornly high but have moderated to some extent. No one is suggesting that these companies will default on their significant debt loads but rather the concern for investors is whether or not the projected impressive ROIC will be realized. The CDS of some sovereign nations is a cogent part of the bear argument; Reuters October report affirmed that the CDS of France soared to 90 before retreating this week to 87bps up from 27 mid-summer. The bears will also zero in on the fact that the Dow Jones Industrials (which are not really "industrials" anymore given the composition of the Index) have had 7 weeks in a row of a lower high. They are also advocates of the negative implications for the economy in view of the unnerving price movement in the Transpos which have also had 7 weeks in a row of a lower high. The most satisfying data point for the bears this week was, of course, that the OpenAI run rate was $20BB below expectations.

4) Resuming a discussion of the impact of the bond market on equities, first, a reminder that Paul Shea, the Miller Tabak Economist, firmly believes that Warsh's increase last month was a "blunder" for reasons explained in his recent reports. If he is correct, we should begin to witness a rally in the government bond market. Fundamentally, one of the key tenets in Shea's scenario, a weakness in the jobs market, has certainly appeared. Moreover, it is virtually inconceivable that with the 30-year fixed income mortgage rate averaging 7.4% as of Thursday that this will not have severe implications for the all-important housing sector of the economy. Mortgage rates have increased for 7 consecutive weeks , the longest run in 3 years, adding 0.84% in borrowing costs over that period, and are at their highest level since November, 2023. The technicals also suggest a forthcoming bounce in government bonds. The DSI by Treasury futures traders has plummeted to an average of 12% over the past 5-12 trading days. Concomitantly, the RSI on the TLT treasury etf is at its lowest level since 2023 immediately before a noteworthy bounce. Yields on the 2, 10, and 30 year bonds did decline this week by 2-3bps. However, it is hard to envision equities grappling well with a move in the 10 year climbing back above 5.3%

5) Physical gold/digital gold: I have been emphasizing for the past several weeks the difficulty GLD has had given the strength of the US$ as the DXY has been registering new weekly highs since early September. Causing the DXY to rise, higher interest rates are a negative for GLD as well. The technical picture is miserable. The 200 day moving average became downward sloping the week of September 28th and GLD has had 6 weeks in a row of a lower high which is compounded by the fact that during those 6 weeks, GLD failed to eradicate the previous week's close 3 times. A rally in the governments would certainly alleviate this downward fundamental and technical picture. As for digital gold, BTC advocates are hoping that the new SEC regulations, of which the Chairman is a friend of crypto, will stir minimal debate and become effective. Comments on the SEC proposals are due by October 20th.

6) The Upcoming Holiday Shopping Season: This is my initial stab as to what equities are telling us about the vital Christmas season. WSM has advanced 12% since mid-September, WMT has "tested" the 102-103 area 4x and has since bounced 7%, and DG is up 7% month-to-date. To this observer, this portends well across all income brackets.

Jeff

Have a productive week..

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