Equity Newsletter

4th Quarter 2026

First Trust

We hold a balanced, moderately positive view of U.S. equities, as we believe robust capital expenditures ("CapEx") should drive economic growth and earnings, while our outlook for consumer spending is mixed. In our view, the artificial intelligence ("AI") buildout supports business CapEx in multiple categories, including not only semiconductors and networking equipment, but also electrical equipment and infrastructure. Beyond AI, reshoring initiatives to secure supply chains and avoid tariffs are also supportive of business investment. The outlook for consumption is more mixed, in our view. Although we expect a strong wealth effect to benefit high-end consumers, we believe lower-income consumers will be impacted by gas prices, currently elevated interest rates, and moderating wage growth. Overall, we anticipate the benefits of strong economic growth to lift earnings for a broader set of companies beyond mega-cap market capitalization names, extending to a more diverse set of sectors beyond technology.

We see the overall equity market as reasonably priced given our expectations for strong corporate profits. As of September 30th, 2026, the S&P 500 Index was valued at about 19x forward earnings over the next 12 months (Chart 1), lower than the multiple at the start of the year, despite the S&P 500 Index returning roughly 13% in the first nine months of 2026. The lower multiple is the result of higher earnings estimates, as earnings grew a combined 39% year-over-year for the first two quarters of the year, with earnings growth of 26% expected for the second half of the year.

Additionally, earnings revisions for 2027 have been trending in a positive direction, not only for the S&P 500 Index, but for the S&P MidCap 400 Index and the S&P SmallCap 600 Index as well (Chart 2).

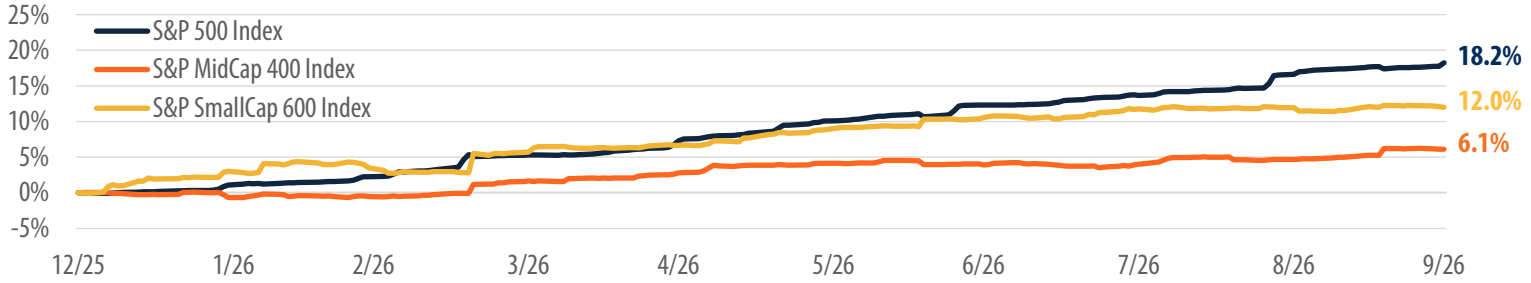
We continue to believe that robust business investment will support economic growth, and lift earnings across a range of companies beyond just the largest market cap names. Despite uncertainty stemming from the Strait of Hormuz, and the upcoming U.S. midterm congressional elections, we continue to believe that fundamentals and earnings growth are key drivers of long-run success in equity markets.

Chart 1: S&P 500 Forward P/E



Source: Bloomberg. Data from 12/31/96-9/30/26. Forward Earnings of S&P 500 is the next-twelve-month consensus estimate.

Chart 2: 2027 Earnings by Market Cap Range - Revisions



Source: Capital IQ. Data from 12/31/25 – 9/30/26. Estimates are based on calendar year 2027 aggregate consensus.

Past performance is no guarantee of future results.

The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. The **S&P SmallCap 600 Index** is an unmanaged index of 600 companies used to measure small-cap U.S. stock market performance. The **S&P MidCap 400 Index** is an unmanaged index of 400 companies used to measure mid-cap U.S. stock market performance. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Investors cannot invest directly in an index.

Forward price-to-earnings (P/E) is the price of a stock divided by estimated forward earnings.

There is no assurance any forecasts will be achieved. Diversification does not guarantee a profit or protect against loss.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Sector Views

Communication Services
- We believe agentic AI adoption may lead to a dramatic inflection in utilization for AI cloud service providers.
- Consumer AI agents, such as Meta's Muse, may increase engagement with consumers, leading to the potential for increased monetization from advertising and subscriptions.
- Cloud service providers increasing CapEx to build out AI capacity as adoption increases. Return on CapEx investment is the key question for the industry, in our view.

Consumer Discretionary
- The outlook for the consumer is mixed, in our view.
- While wage growth has been slowing in recent months, and job additions have been uneven, unemployment remains moderate at 4.2% as of September 2026.
- Headline inflation has remained above 3% year-over-year for six months in a row, which is a particular hardship for low-income consumers, while high earners tend to benefit more from a positive wealth effect from rising asset prices.
- Increasing e-commerce penetration and automation of warehouses are secular positives for profitability.

Consumer Staples
- Defensive sector relatively unexposed to AI disruption, but offers what we see as relatively meager growth.
- Valuation not particularly attractive, in our view.

Energy
- The U.S. Energy Information Administration (EIA) forecasts that improving convoys through the Strait of Hormuz, alternative routing and ship-to-ship transfers, such as in the Gulf of Oman, will lead to increased Middle East oil exports. That said, the EIA raised its forecast for fourth quarter oil prices, noting that upward pressure on crude prices stems not only from geopolitical risk, but also from the extreme tightness in diesel markets.
- Energy sector equities provide a hedge against any re-escalation of Middle East geopolitical tensions, in our view.

Financials
- We expect solid loan growth, including robust commercial and industrial (C&I) loan growth, as we believe the outlook for business capital expenditures is strong. Reshoring also provides a tailwind to C&I growth, in our view.
- We expect a more industry-friendly regulatory stance towards banking, including less scrutiny of mergers and acquisitions, and easing of capital requirements.
- Investment banking and trading surged in the second quarter, and in our view, should remain solid going forward, even if growth moderates.
- Credit quality remains reasonable, in our view.
- AI adoption may increase efficiency in the financials sector through automation of underwriting, fraud detection and document processing.

Healthcare
- We expect increasing consolidation in the biopharma industry as big pharma replenishes its pipelines.
- Provides potential opportunity to invest in growth that is less correlated to the business cycle.
- The life science tools industry stands to benefit from an improvement in the biopharma capital equipment spending environment, in our view. AI may also result in more lab spending, as the industry builds out more capacity to generate data to train AI models. We expect improving bioprocessing growth over time.
- Valuation is attractive in the sector, in our opinion.

Industrials
- Increasing infrastructure requirements to support data centers is a key secular driver for some industrial firms.
- Reshoring initiatives to secure supply chains and avoid tariffs are also supportive of business investment in capital equipment and construction, in our view.
- Strong recent Institute for Supply Management (ISM) manufacturing readings indicate expanding industrial activity.
- Defense industry names tend to benefit from increasing geopolitical risk, as well as a potential increase in defense spending on the part of U.S. allies over time. That said, a blue wave in the U.S. midterms could lead to increased uncertainty in defense spending.
- We see increasing innovation in the aerospace and defense industry, such as space technologies and drone warfare.

Information Technology
- We expect robust information technology corporate spending driven both by AI-related capital spending and in end markets outside of AI, such as traditional enterprise servers.
- Key semiconductor end markets such as AI, high-bandwidth memory, and vehicle electrification may benefit from secular tailwinds.
- While we believe AI brings disruptive changes to the software industry, particularly for software as a service (SaaS), AI also provides an edge for firms that successfully integrate AI capabilities into their business models. We see cybersecurity and infrastructure software as key AI beneficiaries.

Materials
- Macro-sensitive sector may benefit from spending on construction and infrastructure.
- We believe incremental demand from clean energy grid infrastructure and electric vehicle transition is a secular positive for some metals, such as copper.
- We believe the materials sector may benefit over time from policies and investment designed to reshore supply chains and improve resource security amid geopolitical tensions.

Real Estate Investment Trusts (REITs)
- Higher-yielding sector sensitive to interest rate movements, potential to benefit if rates decline.
- In our view, data center REITs provide a strong secular opportunity but, on a cyclical basis, are sensitive to the information technology spending environment.

Utilities
- Utilities are sensitive to interest rate movements and have underperformed the broader market in recent months. Utilities may benefit if interest rates have peaked, in our view.
- Data center power consumption is a source of secular growth in electricity demand.
- Defensive, dividend-paying nature typically more attractive in times of macroeconomic uncertainty.



International Views

DEVELOPED MARKETS

Europe

- We expect slower European macroeconomic growth relative to the U.S.
- Europe's economy is more vulnerable to energy price spikes given its reliance on energy imports, particularly diesel fuel.
- European exports face headwinds from increased competition from China.
- Inexpensive valuation in comparison to U.S. stocks, but less exposed to innovation, in our view.
- Concerns about France's fiscal difficulties and uncertain political climate may impact sentiment towards Europe.
- Geopolitical risk not only from the Middle East and Ukraine/Russia conflicts, but also increased influence of populism on national politics within the Eurozone.

United Kingdom

- We expect relatively slow macroeconomic growth.
- The U.K. has limited flexibility to stimulate its economy via fiscal policy due to its deficit and the potential for a negative reaction in the market for U.K. gilts.
- Elevated energy prices may result in more hawkish monetary policy by the Bank of England, in our view.
- Inexpensive valuation in comparison to U.S. stocks, in our view.

Japan

- Japan's industrial and capital equipment exports stand to benefit from AI and infrastructure investments, in our view. We believe "friend-shoring" and the potential for increased secular demand for advanced technology exports such as automation equipment are also constructive for Japanese firms.
- Strong readings for the September Manufacturing PMI and Tankan Manufacturing survey indicate a robust outlook for industrial activity, in our view.
- We expect corporate governance reforms to improve capital efficiency via increased share buybacks and less cross-shareholder ownership, offering the possibility for higher return on equity for Japanese corporations over time.

Australia

- We expect moderate economic growth, driven by business investment in data centers and energy infrastructure.
- Exports of raw materials are another key driver of economic growth.
- Weak housing market is a risk to domestic consumption, in our view.

Canada

- U.S. is key trading partner and Canada stands to benefit from strong U.S. growth; that said, U.S.-Canada trade policy uncertainty remains a risk, in our view.
- Energy and metals exporter, which stands to benefit when oil prices rise and demand for basic materials is strong, would likely be sensitive to any slowdown in U.S. economic growth, or weak commodity prices, in our view.

EMERGING MARKETS

Emerging Asia

- Chinese exports have been robust, driven by technology. Domestic demand remains soft, with tepid retail sales and declining fixed asset investment in property and infrastructure.
- While Chinese policymakers have announced new fiscal and monetary policy stimulus, it remains unclear if the measures are sufficient to reaccelerate growth, in our view.
- Geopolitical tensions present risk to Chinese exports, with disagreements building between the EU and China over trade imbalances.
- Taiwan and Korea are key exporters of semiconductor and electronic components, which creates opportunity when technology spending is high, but presents risk if demand for technology slows, in our view.

Latin America

- The Mexican economy stands to benefit from exports to the U.S.
- Supply chain diversification away from China may be a structural tailwind to exports.
- Brazil and Latin America overall are sensitive to demand for commodity exports.
- Political environment in Latin America is becoming more business-friendly, in our view.

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