Investment Narrative

Quarter Ending September 30, 2026

San Diego Foundation

During the third quarter of 2026, the U.S. economy continued to expand, though persistent inflation and rising interest rates created a more challenging environment for investors. Revised GDP figures showed a stronger first half of the year than previously reported, with inflation-adjusted economic growth of 2.5% in the first quarter and 2.2% in the second, measured at annualized rates. Investment in artificial intelligence (AI) remained an important source of support and growth. Inflation continued to strain household budgets, with consumer prices rising 3.7% over the past year, largely due to higher energy costs. Consumer confidence weakened as energy and housing became more expensive. The labor market remained stable, with unemployment at 4.2%, though hiring was slow. In September, the Federal Reserve raised interest rates by 0.25 percentage points to help bring inflation under control.

U.S. stock market returns were mixed following the strong rebound in the second quarter. Large-cap equities, as measured by the S&P 500 Index, gained 2.3%, while small-cap equities, represented by the Russell 2000 Index, declined 7.2%. Higher borrowing costs weighed more heavily on smaller businesses, which tend to be more sensitive to changes in interest rates and economic conditions. Bond markets also faced pressure as Treasury yields rose sharply in September. As a result, the Bloomberg U.S. Aggregate Bond Index declined 3.5% for the quarter. Commodities, including energy and other raw materials, performed better, with the Bloomberg Commodity Index gaining 16.2%. Overall, the quarter brought more modest stock market gains and a setback for bonds, as inflation and interest rates remained central concerns for investors.

Outside the U.S., developed international and emerging markets experienced uneven economic and investment conditions. Developed economies generally grew slowly as higher energy costs and trade tensions weighed on activity, partly offset by government spending and investment in artificial intelligence. Largely due to the broader trend of AI investments, emerging economies generally grew faster, although conditions varied across regions. Generally, the themes observed in Q2 continued into Q3—European countries faced ongoing economic issues, countries key to AI's development benefitted from continued investment, and countries dependent on energy-related imports experienced prolonged uncertainty. Developed international equities, represented by the MSCI EAFE Index, gained 0.8%, while emerging market equities, represented by the MSCI Emerging Markets Index, declined 0.4%. Together, these results reflected a more difficult global investment environment.

Endowment Portfolio

The Endowment Portfolio delivered a 1.1% net return for the quarter, modestly outperforming its benchmark, and a 12.3% net return over the past year, ahead of its benchmark by 1.2 percentage points. During the quarter, private investments, particularly private equity, were the main source of gains. Publicly traded equities and real assets, such as infrastructure and natural resources, also contributed, offsetting losses in bonds, hedge funds and real estate. Over the past year, returns were supported by gains across public equities, including international holdings and private markets.

Long-Term Portfolio

The Long-Term Portfolio declined 0.4% for the quarter, slightly behind its benchmark's 0.3% decline, and delivered an 11.6% net return over the past year, outperforming its benchmark by 0.2 percentage points. Quarterly losses in bonds, small-cap equities and hedge funds outweighed gains in large-cap equities and real assets. Over the past year, equities and real assets were important contributors to overall performance.

Medium-Term Portfolio

The Medium-Term Portfolio declined 1.7% for the quarter, trailing its benchmark by 0.5 percentage points, and delivered a 4.3% net return over the past year, trailing its benchmark by 0.3 percentage points. With approximately 70% of the portfolio invested in fixed income, rising interest rates were the primary source of pressure during the quarter. Over the past year, positive equity returns supported overall results, while recent bond market weakness limited gains.

Intermediate-Term Portfolio

The Intermediate-Term Portfolio declined 2.7% for the quarter, trailing its benchmark by 0.6 percentage points. Its bond allocation was affected by the sharp rise in interest rates, with longer-term holdings experiencing greater losses than shorter-term investments. Over the past year, the portfolio had a net return of negative 0.6%, compared with a 0.2% decline for its benchmark. While rising rates reduced the value of existing holdings, higher rates can also provide opportunities to earn more income as funds are reinvested.

Short-Term Portfolio

The Short-Term Portfolio returned 0.9% for the quarter, matching its benchmark, and delivered a 3.7% net return over the past year, slightly ahead of its benchmark's 3.6% return. The portfolio's cash and money market investments continued to benefit from elevated short-term interest rates and were less affected by the rise in longer-term rates that pressured bond markets. Going forward, performance will continue to be influenced primarily by short-term interest rates and Federal Reserve policy.

Sustainable Endowment and Non-Endowment Portfolios

The Sustainable Endowment and Non-Endowment Portfolios returned 0.5% and 0.6%, respectively, for the quarter, ahead of their benchmarks, which each returned 0.3%. The portfolios are 75% invested in equities, and gains in those holdings more than offset losses in bonds and real assets. Over the past year, the Sustainable Endowment Portfolio delivered an 8.9% net return, compared with 8.7% for its benchmark, while the Sustainable Non-Endowment Portfolio returned 9.0%, compared with 8.8% for its benchmark. Stock investments were the primary source of gains over both periods.