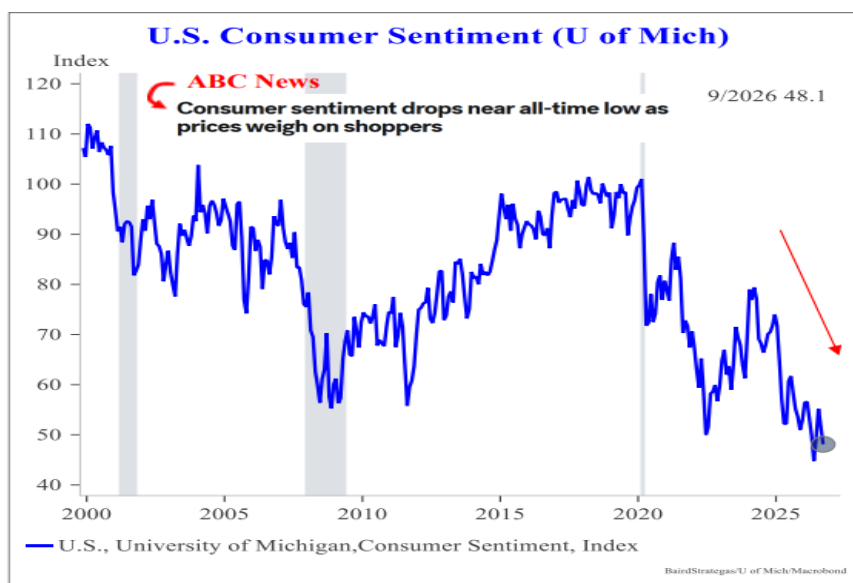


Third Quarter 2026 Commentary

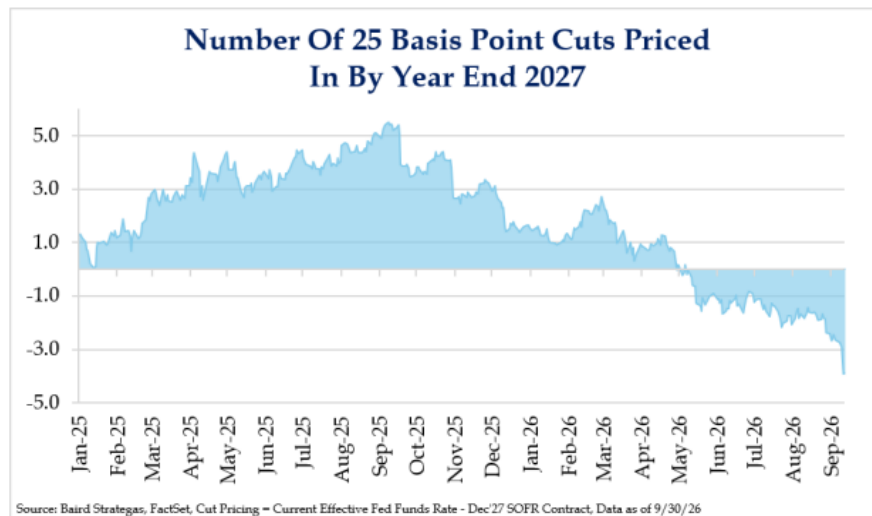
Despite a highly volatile third quarter, relative portfolio performance continues to be favorable. The most consequential feature of the bond market for the quarter was the increase in yields, which approximated 75 basis points across all maturities. Portfolio results for the period benefited from actions we took in previous quarters to reposition portfolios for what we viewed as the growing risk of higher interest rates. These actions included reducing exposure to intermediate and long-term U.S. Treasury securities and focusing corporate bond investments on higher quality issuers at the short end of the yield curve which are less susceptible to the effects of rising interest rates.

For now, given the still uncertain outlook, we believe meaningful exposure to U.S. Treasury securities and a defensive stance with respect to portfolio interest rate exposure is still appropriate. That said, it has been twenty-five years since U.S. Treasury yields have been above the 5.0% level and this presents a meaningful opportunity to secure new investments at very attractive levels. High-quality corporate bonds with modest interest rate risk are now trading at levels close to 6.0 percent, with many high yield bonds yielding 7.0% or more. At the appropriate time, this will present a very compelling opportunity to again reposition portfolios by reducing U.S. Treasury security exposure in favor of corporate bonds laying the foundation for very favorable returns in the years ahead.

Despite the continued headwind of worsening affordability, stemming in large part from the prolonged War in Iran and the resulting spike in energy prices, the economy continues to grow at an extraordinary pace. Current estimates are that GDP will have likely advanced at an 8.0% nominal pace for the third quarter, benefitting in large part by the investments being made in AI and data center construction. While there have been occasional readings on the labor market and retail spending that highlight a more fragile economy beneath the surface, the multi-month trend of both measures continues to remain positive. Interestingly however, and contradictory to the positive trend seen in the spending data, measures of consumer sentiment have dropped to near all-time lows as elevated oil prices and continued inflation weigh on the consumer outlook. Given that consumer spending accounts for two thirds of economic output, this sentiment survey is a troubling data point. We would expect that given the lagged effect of higher energy prices coupled with this survey, that economic growth (consumer spending) will begin to moderate as we enter the winter heating season.



With the War in Iran at an impasse as we approach the mid-term elections, energy prices again moving higher, and economic growth surpassing estimates, the FOMC voted at the September meeting to raise interest rates for the first time since July 2023. The move to tighten policy reflects minimal progress having been made over the past year to bring inflation down further from its current level of 3.0% toward the committee's goal of 2.0%. The previous progress made to bring the inflation rate down to its current level, coupled with evidence of a weakening economy and expectations that the decline in prices would continue, led the Federal Reserve to cut rates by 75 basis points in the second half of 2025. In hindsight, this policy response appears to have been premature and it is likely that under the leadership of new Fed Chair Kevin Warsh, the Fed will continue to remove this accommodation over the course of the next several meetings.



Throughout the third quarter bond market pricing reflected the growing expectation of a Fed rate hike, with yields steadily increasing leading up to the September FOMC meeting, with additional yield increases continuing afterwards as well. The surge in yields however, cannot solely be assigned to the elevated inflation data and the Federal Reserve response. The fiscal deficit and the associated level of U.S. government debt issuance is equally at play. The growing supply of U.S. government debt, made worse by growing costs of the War in Iran, has begun to get more and more investor attention and yields on longer term government bonds are being repriced to reflect this worsening supply/demand outlook. In addition to higher interest rates, which further strain affordability, a myriad of additional concerns face the economy as well at a time when equity and credit valuations are near all-time highs:

- Inflation is high and affordability is low, pressuring the economic outlook and the consumer.
- The development of Artificial Intelligence, a meaningful source of growth in the economy, is being scrutinized by both the private sector and government officials.
- The Federal Reserve has set a course for a tightening campaign that could last several quarters.
- The War with Iran is ongoing with re-escalation likely after the mid-term elections.

As we enter the final months of the 2026, we are mindful that riskier segments of the market could begin to price in a negative outcome to any of the above, and as such, we are monitoring closely the recent underperformance of high yield corporate bonds.