

Fixed Income Outlook

4Q26

Key Takeaways:

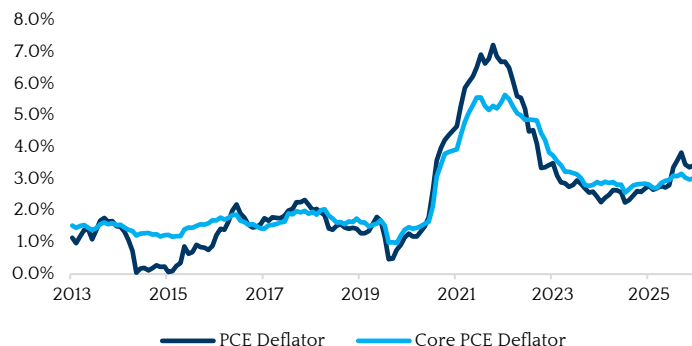
1. Persistent inflation and expectations for additional Fed tightening drove Treasury yields sharply higher in the quarter, pushing bond returns modestly into negative territory.
2. The path of interest rates remains highly uncertain, with the Iran war, oil prices, tariffs, and the midterm elections all capable of influencing the length of the Fed's hiking cycle.
3. The U.S. economy remains resilient enough to absorb tighter monetary policy in the near term, supported by low unemployment, strong corporate profits, and robust consumer spending.
4. Higher yields make investment-grade bonds more attractive, but recent volatility may reinforce the case for diversified, high-quality portfolios focused on income, liquidity, and principal protection.

Fixed income markets jumped back into the headlines as yields rose over the third quarter. Inflation has become the primary focus of the Federal Open Market Committee (the Fed) as it pursues a tightening cycle. Yields rose across the curve in reaction, pushing year-to-date bond returns into the red. Forecasts for a series of rate hikes are muted, only three hikes are expected, amid uncertainty surrounding global fuel prices, a primary contributor to recent inflation readings.

Shortly after he was sworn in, new Fed Chair Kevin Warsh cited ongoing inflation as a key concern for the committee. In September, the Fed followed through by raising rates by 25 basis points, seeking to curb price increases. Market participants anticipated the move, pushing yields upward throughout the quarter.

The Fed usually does not stop at one hike, and the futures markets currently reflect this with expectations of three more rate increases. Three hikes would appear to be a very, very short cycle, suggesting that the war with Iran remains a factor. Higher oil prices have been a strong driver of inflation for both consumers and businesses. Should the Iran war end quickly and oil prices recede, inflation could be tempered without a long series of Fed hikes.

Personal Consumption Expenditures Price Indices, Year-Over-Year
2019 to 2026

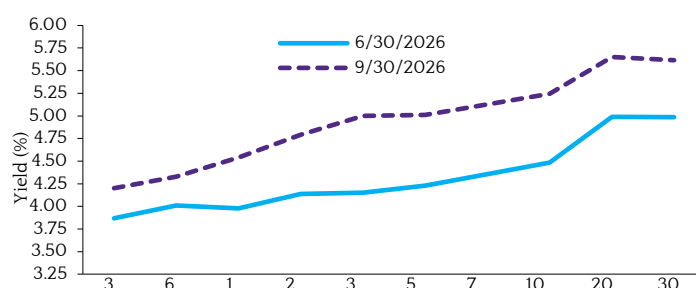


Source: Bloomberg as of 9/30/2026

Inflation measures have been above the Fed's target rate of 2% since early 2021. A series of hikes by the Fed that ended in 2023 helped stave off a more persistent bout of inflation as the U.S. emerged from the global pandemic. Yet inflation remained stubborn and did not fall appreciably in the following years.

To be certain, tamping down inflation with rate hikes would not be possible for the Fed without the strength of today's economy. Unemployment remains low, corporate profits remain high, and consumer spending has been remarkably stout. There is little fear that the Fed's actions will push the economy into a recession in the near term given these underlying economic strengths. Recession fears may be a concern much further out in time, but not for the rest of this year.

U.S. Treasury Yield Curve on June 30, 2026 and September 30, 2026



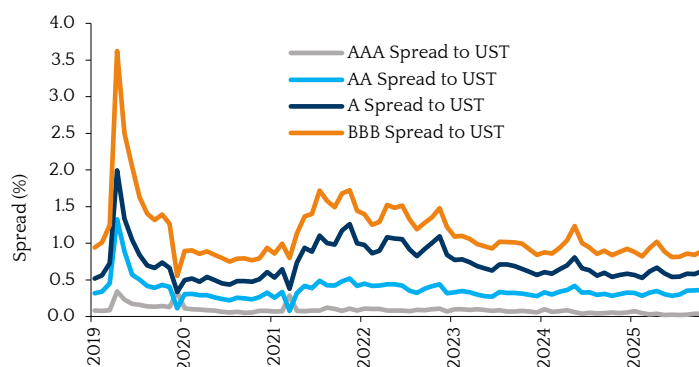
Source: Bloomberg as of 9/30/2026

Over the third quarter, the U.S. Treasury yield curve rose by approximately 70 basis points from the 2-year out to the 10-year maturity point. This broad shift higher was driven by expectations of persistent inflation. Fed official commentary referenced heightened inflation fears, which bolstered those expectations. These "hawkish" overtones became stronger as pricing data worsened and Warsh took the helm at the Fed.

Investment grade corporate bond issuance has been strong this year. Part of the surge is clearly tied to the notable capital spending on data center construction as technology companies vie for an edge in the rapidly expanding artificial intelligence sector. The remainder appears to be normal borrowing or refinancing as corporations seek to lock in financing before interest rates are pushed higher by the Fed.

Credit spreads, or the additional yield required by investors to compensate for default risk, remain largely unchanged, despite the massive issuance levels and a slight widening in the quarter. There seems to be little fear of default among investment grade credit investors, which is troubling. Investors have already forgotten the failures of Silicon Valley Bank, Signature Bank, and Silvergate Bank, all occurring in March 2023. Spreads remain historically narrow and we remain selective buyers of credit for this reason.

Intermediate Investment Grade Credit Spreads (OAS) by Quality Rating
Cohort December 2019 to September 2026



Source: Bloomberg as of 9/30/2026

Performance data reflects the rise in yields (prices fell) as returns for the quarter, year-to-date, and trailing 1-year periods were negative. To be clear, the returns are not deeply negative as we saw back in 2022 when the Fed hiked multiple times. Instead, returns for intermediate maturity indices are just slightly negative. Credit returns suffered more than U.S. Government guaranteed issues over the quarter due to their longer average maturity and, thus, greater sensitivity to rising rates.

Forecasting is difficult in normal times and given today's environment it is downright treacherous to predict future events. Some of the more confounding elements include the war with Iran, tariff regulation, and midterm elections. Separately, each of these policy areas could have strong impacts on consumers, businesses, and markets. Together they provide a wide array of potential scenarios, as none are necessarily binary events.

Midterm elections could signal changes with a broad range of outcomes. Changing control of the House and the Senate could mean immediate policy changes on many fronts. A split of control could mean legislative gridlock or selective changes in policy. The elections are the largest wildcard in forecasting upcoming market-moving events.

The war with Iran and tariffs appear to be persistent drivers of near-term inflation. If these policies remain unchanged, inflation may continue and could steer the Fed into a longer series of interest rate hikes. For this reason, we expect interest rates to remain elevated into the midterm election period.

Rather than tie our fixed income strategy to a forecasted outcome, we build portfolios of high-quality, investment-grade bonds that are diversified. These portfolios seek to offer liquidity, strong credit ratings, and principal protection. Our strategies seek to perform well, regardless of the interest rate environment.

Given the higher yield environment, investment-grade bonds may become more appealing to investors previously out of the market. If the markets are at an inflection point with the upcoming midterm elections, it might be prudent for clients to reassess their allocation across different asset types. Increasing exposure to investment grade bonds may help smooth portfolio volatility amid the uncertainties ahead.

John Beaver, CFA® | Portfolio Manager

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Fixed Income Risks

Credit Risk: The risk that an issuer of a fixed income security will fail to make interest payments or repay principal when due, in whole or in part. Changes in an issuer’s financial strength, the market’s perception of an issuer’s creditworthiness, or in a security’s credit rating may affect a security’s value. In addition, investments in sovereign debt involve a heightened risk that the issuer responsible for repayment of the debt may be unable or unwilling to pay interest and repay principal when due, and the Strategy may lack recourse against the issuer in the event of default. Investments in sovereign debt are also subject to the risk that the issuer will default independently of its sovereign. Below investment grade securities (high yield/junk bonds) have speculative characteristics, and changes in economic conditions or other circumstances are more likely to impair the ability of issuers of those securities to make principal and interest payments than is the case with issuers of investment grade securities.

Extension Risk: The risk that if interest rates rise, repayments of principal on certain debt securities, including, but not limited to, floating rate loans and mortgage-related securities, may occur at a slower rate than expected and the expected maturity of those securities could lengthen as a result. Securities that are subject to extension risk generally have a greater potential for loss when prevailing interest rates rise, which could cause their values to fall sharply.

Interest Rate Risk: The risk that debt instruments will change in value because of changes in interest rates. The value of an instrument with a longer duration (whether positive or negative) will be more sensitive to changes in interest rates than a similar instrument with a shorter duration. Bonds and other debt instruments typically have a positive duration. The value of a debt instrument with positive duration will generally decline if interest rates increase. Certain other investments, such as interest-only securities and certain derivative instruments, may have a negative duration. The value of instruments with a negative

Prepayment Risk: The risk that the issuer of a debt security, including floating rate loans and mortgage related securities, repays all or a portion of the principal prior to the security’s maturity. In times of declining interest rates, there is a greater likelihood that the Strategy’s higher yielding securities will be pre-paid with the Strategy being unable to reinvest the proceeds in an investment with as great a yield. Prepayments can therefore result in lower yields to shareholders of the Strategy.

General Market Risk: Economies and financial markets throughout the world are becoming increasingly interconnected, which increases the likelihood that events or conditions in one country or region will adversely impact markets or issuers in other countries or regions. Securities in the Strategy’s portfolio may underperform in comparison to securities in the general financial markets, a particular financial market, or other asset classes due to a number of factors, including: inflation (or expectations for inflation); deflation (or expectations for deflation); interest rates; global demand for particular products or resources; natural disasters or events; pandemic diseases; terrorism; regulatory events; other governmental trade or market control programs and related geopolitical events. In addition, the value of the Strategy’s investments may be negatively affected by the occurrence of global events such as war, terrorism, environmental disasters, natural disasters or events, country instability, and infectious disease epidemics or pandemics.

Municipal Securities Risk: Investing in various municipal securities may involve risk related to the ability of the municipalities to continue to meet their obligations for the payment of interest and principal when due. A number of municipalities have had significant financial problems recently, and these and other municipalities could, potentially, continue to experience significant financial problems resulting from lower tax revenues and/or decreased aid from state and local governments in the event of an economic downturn. This could decrease the Strategy’s income or hurt the ability to preserve liquidity.

U.S. Government and Agency Issuer Risk: Treasury obligations may differ in their interest rates, maturities, times of issuance and other characteristics. Obligations of U.S. Government agencies and authorities are supported by varying degrees of credit but generally are not backed by the full faith and credit of the U.S. Government. No assurance can be given that the U.S. Government will provide financial support to its agencies and authorities if it is not obligated by law to do so.