National
Investment Services

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THIRD QUARTER, 2025

Investment Review

FIXED INCOME OVERVIEW

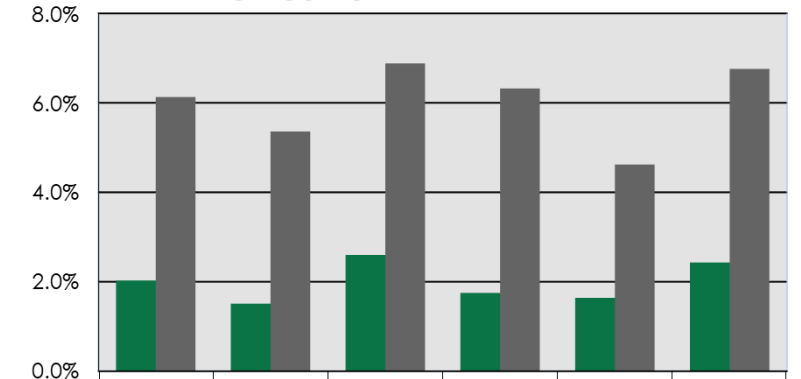
The U.S. bond market posted another positive quarter as rates moved lower in anticipation of what turned out to be a 25-basis-point cut in the Fed Funds Rate in September. Bond market participants appeared eager to add both duration and risk as the quarter drew to a close.

The Bloomberg Aggregate Index gained 2.03% in the quarter, primarily driven by strength in corporate bonds and Agency MBS. Generally, it was a decent quarter for most sectors within the investment-grade bond market. Long-duration utilities (+4.15% for the quarter) led the way within the corporate arena, while Industrials finished +2.62%. The Bloomberg Intermediate Govt/Credit Index ended up 1.51% as all areas of the curve benefited from the market moves. The Bloomberg 1-3 year Govt/Credit Index returned 1.19% providing investors aligned with the Index a decent return.

Article Highlights

- Bonds enjoyed a favorable backdrop in Q3
- Credit Spreads are tight
- Inflation readings have ticked higher
- Cautious investment risk posturing

Bloomberg Aggregate Index Sector Performance



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q3 25'	2.03%	1.51%	2.60%	1.75%	1.64%	2.43%
YTD	6.13%	5.36%	6.88%	6.32%	4.62%	6.76%

Source: Bloomberg

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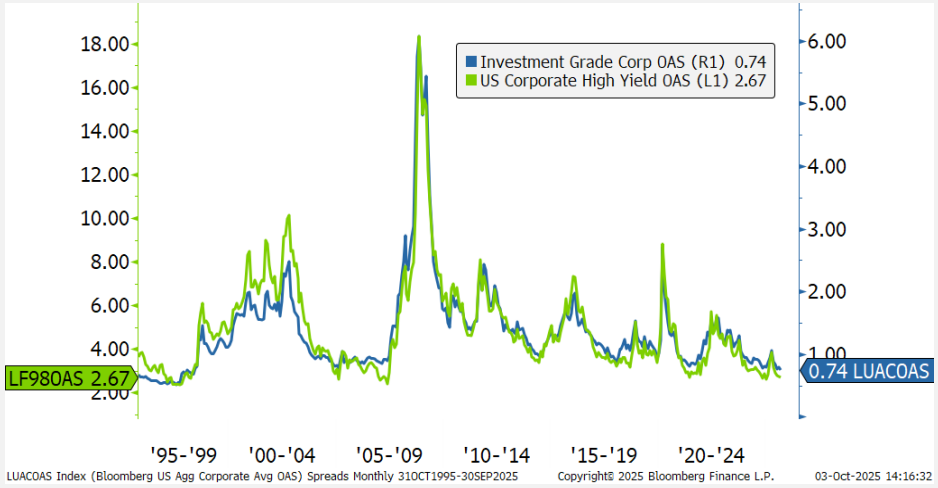
Credit Spreads

Investment-grade corporate credit spreads (blue line) dropped another nine basis points as the market for spread duration and "all-in yield" took precedence over safety. High-yield bonds (green line) exhibited a similar path, as investors remained quite happy with the underlying strength of both the overall economy and the business operations and earnings of corporations in general. The chart below shows both investment-grade and high-yield markets trending toward their multi-decade tight trading levels.

Credit Spreads



Source: Bloomberg

The Economy

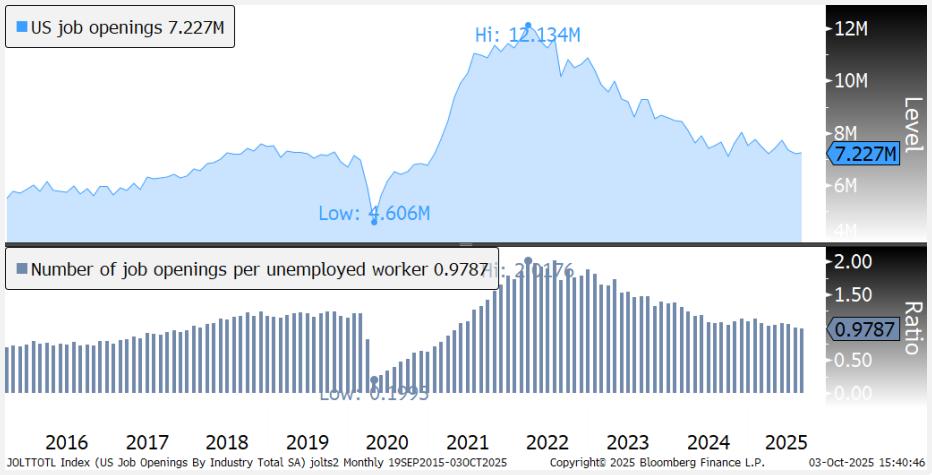
Resilience continues to describe the current state of our domestic economy, with the second-quarter GDP showing a slight acceleration compared to earlier in the year. Both Goods and Services areas contributed to the relative strength, and Motor Vehicles went from a negative to a positive. Healthcare, Insurance, Food, and Accommodations all helped drive solid results within the Services arena for the quarter.

The Housing market is showing real signs of slowing, but much of that was expected as its growth phase became somewhat unsustainable. The sheer amount of home equity in the United States is trending around $17 trillion, with the average household, according to CBS News, showing approximately $200,000 of borrowing capacity while maintaining a 20% equity level. We readily admit that this statistic does not apply to everyone, but we believe it partially explains why the economy and inflation is not slowing down.

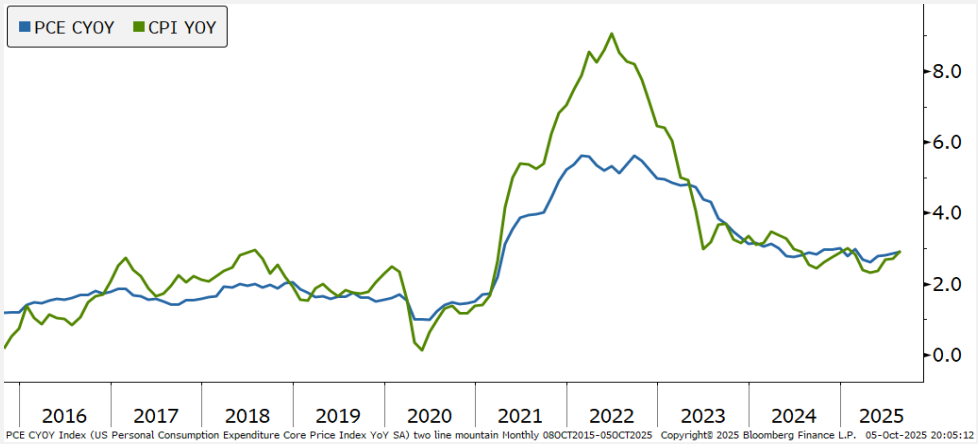
Job Market Equilibrium

The labor market took center stage during the quarter after the Bureau of Labor Statistics released the July Non-Farm Payroll data. Both May and June job gain numbers were revised sharply lower, resulting in a reduction of over 250,000 jobs. Immediately following the release, equities exhibited a brief bout of weakness, while the bond market rallied as the chances for a Fed rate cut at the September meeting increased dramatically. While there is little to argue that the labor market is indeed slowing, by looking at available openings versus unemployed workers, we find that the balance finally looks to be normal. Unfortunately, normal never seems to last long.

Source: Bureau of Labor Statistics, Bloomberg



3% Inflation is the New 2% Inflation



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Bloomberg

Speaking of not lasting long, the downtrend in inflationary readings that we had earlier in the year seems to have disappeared, since both PCE (the Fed's preferred gauge) and CPI have turned up recently, as highlighted in the chart above. Federal Reserve Board Chair Powell, as well as other committee members, have recently noted this complicated reality. And in examining the Fed's own projections, it appears they target PCE to end the year around 3.1% which is quite a bit higher than the 2% goal. The newest voting member, Stephen Miran, views policy as still too restrictive and bucked the 25-basis-point trend by advocating for a larger 50-basis-point cut. He believes that the current policy is not taking into account the recent changes to immigration policy and a slowdown in rent inflation. Time will tell on where the inflation numbers will land, but it feels pretty anchored around 3% to us.

Fourth Quarter, 2025 STRATEGY

We remain somewhat surprised, although impressed, by the overall resilience of risk markets as we enter the final quarter of the year. Markets have basically shrugged off most trade policy newsflow and even the recent political stalemate surrounding the U.S. Government shutdown. The month of September saw a record primary issuance. Within the Investment-Grade Corporate bond market, with more than $200 billion of supply being met by strong demand from investors. We continue to hold an overweight position in financials and made modest additions to allocations throughout the quarter, aided by the primary market. The financial sector continues to benefit from a favorable regulatory environment and the prospect of reduced capital requirements from the Fed. Long-duration Corporate bond spreads tightened relative to 10-year Corporate spreads during the quarter, and we trimmed a couple of longer-duration bonds. After reducing investments in the energy sector, our managers have been adding to both the Consumer Cyclical and Non-Cyclical sectors, as well as the Technology sector. The Consumer sector appears solid, and AI-driven spending continues.

In auto ABS, spreads for prime and subprime seniors appear tight versus historical levels, but still offer some value relative to short-term corporate bonds. In esoteric ABS, we aim to add seasoned discount containers and private student loans while working to limit our exposure to certain negatively convex premium ABS bonds as interest rates continue to move lower. Within CMBS, we are sticking to bonds at or near the top of the stack. New issue last cash flows (LCFs) remain somewhat cheap to corporates, but we prefer mezzanine AAAs at 40 bps back of LCFs.

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Chief Strategy Officer

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