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ALERUS WEALTH UPDATE

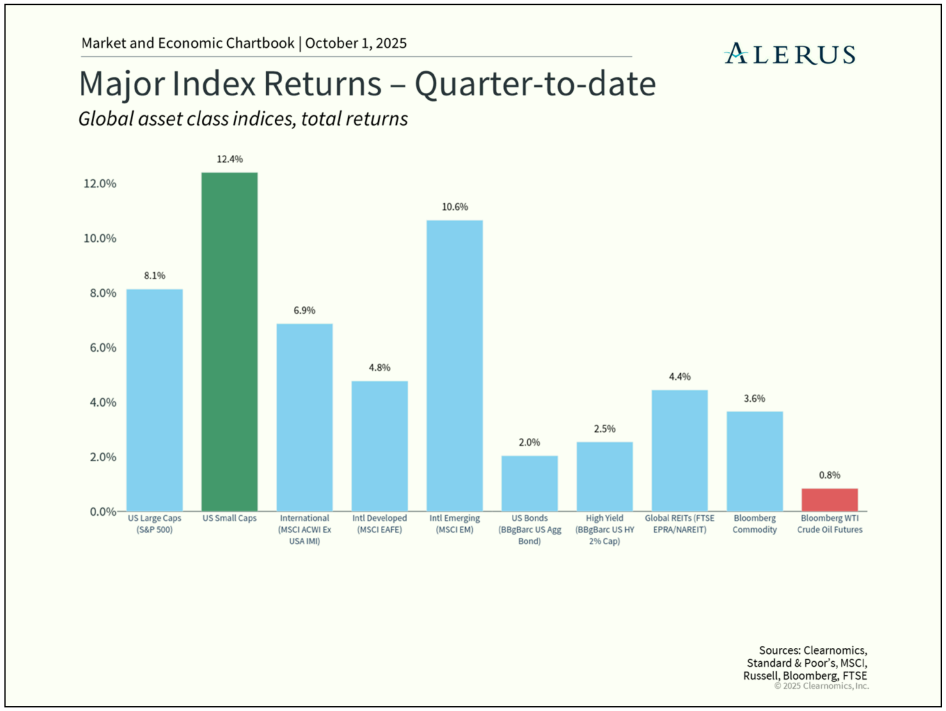
Everything Rally

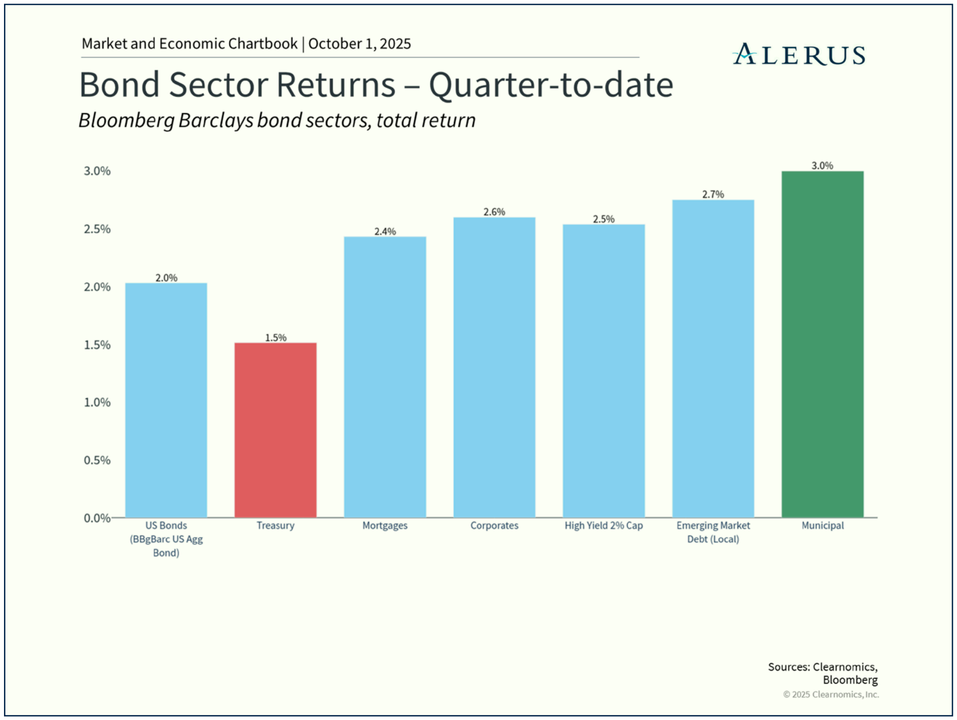
Stocks, bonds, gold, and real estate all rose in the third quarter with gold prices leading the way, up 16.6% in the quarter. Improving economic data and a softening labor market paved the way for the Federal Reserve (Fed) to cut rates in September – their first cut since December 2024. This dynamic offered investors a “Goldilocks” backdrop – lower rates fueling higher equities. Investor sentiment was further buoyed by robust corporate profit growth and investment in artificial intelligence hardware and software. The passage of the One Big Beautiful Bill, offering tax incentives for corporate capital expenditures, reduced policy uncertainty and increased investor confidence in the U.S. economy. As the labor market showed signs of slowing, the Fed not only cut its benchmark rate in September but indicated additional easing through 2026. Falling yields helped bonds deliver solid returns to close out the quarter.

Bonds: Fed Begins a Rate-Cutting Cycle

In September, the Fed cut its benchmark rate by 25 basis points to a target range of 4.00–4.25%– its first move this year. Despite inflation remaining above the Fed’s 2% target, Chair Powell cited “rising downside risks to employment,” framing the decision as a “risk management” cut. The Fed’s dot plot points to two additional cuts in 2025. Treasury yields responded: the 10-Year fell 8 basis points to 4.15%, and the 2-year dropped 11 bps to 3.61%. Declining yields and strong yield carry drove solid bond returns. The Bloomberg U.S. Aggregate Bond Index rose 2% in the third quarter and 6.1% year-to-date through September. The yield curve steepened as Fed rate cuts were priced to the terminal rate.

Investment grade corporate bonds delivered a 2.6% total return, supported by steady demand and elevated yield carry, amid a backdrop of strong corporate profits and cautious optimism resulting from the economic outlook. Credit spreads continued to tighten throughout the quarter, reflecting improved investor sentiment and a shift toward higher-quality assets. Option-adjusted spreads narrowed by 9 basis points over the period, ending





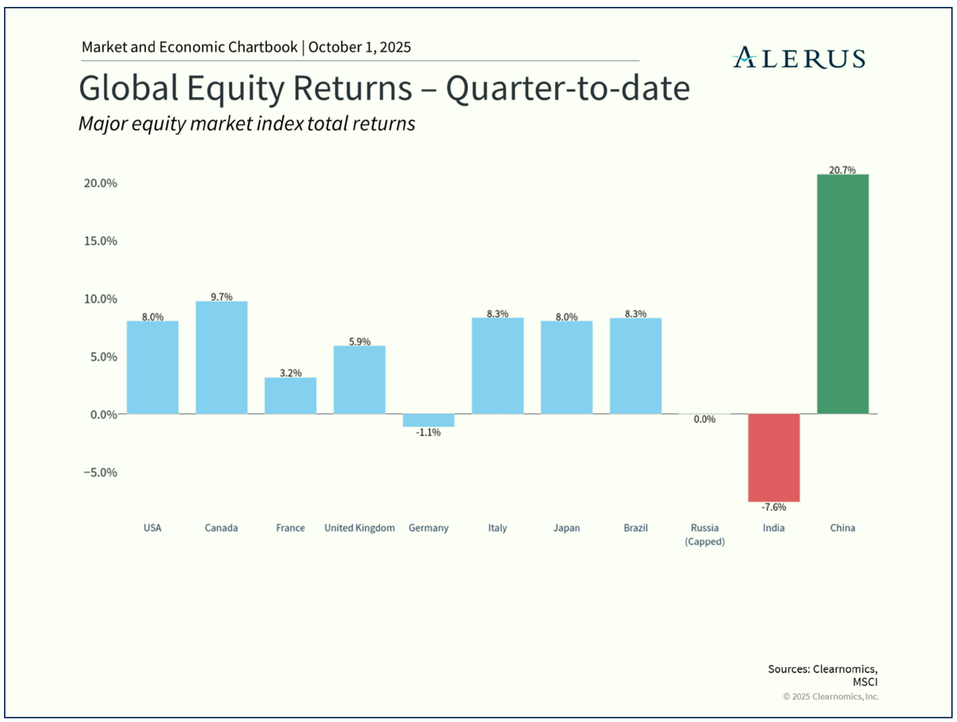
at +74, well below the levels seen earlier in the year during periods of heightened volatility. High yield bonds continued to perform well in the third quarter, with a total return of 2.5%, supported by strong yield carry and improving investor sentiment. Credit spreads tightened by approximately 23 basis points, ending the quarter near +267 on an option-adjusted basis, as risk appetite remained resilient despite lingering macroeconomic uncertainty. The asset class benefited from low default rates, stable corporate earnings, and consistent inflows, particularly into higher-quality issuers. BB-rated bonds led performance, reflecting a preference for quality amid cautious optimism, while CCC-rated names also posted gains as sentiment toward riskier credits gradually improved.

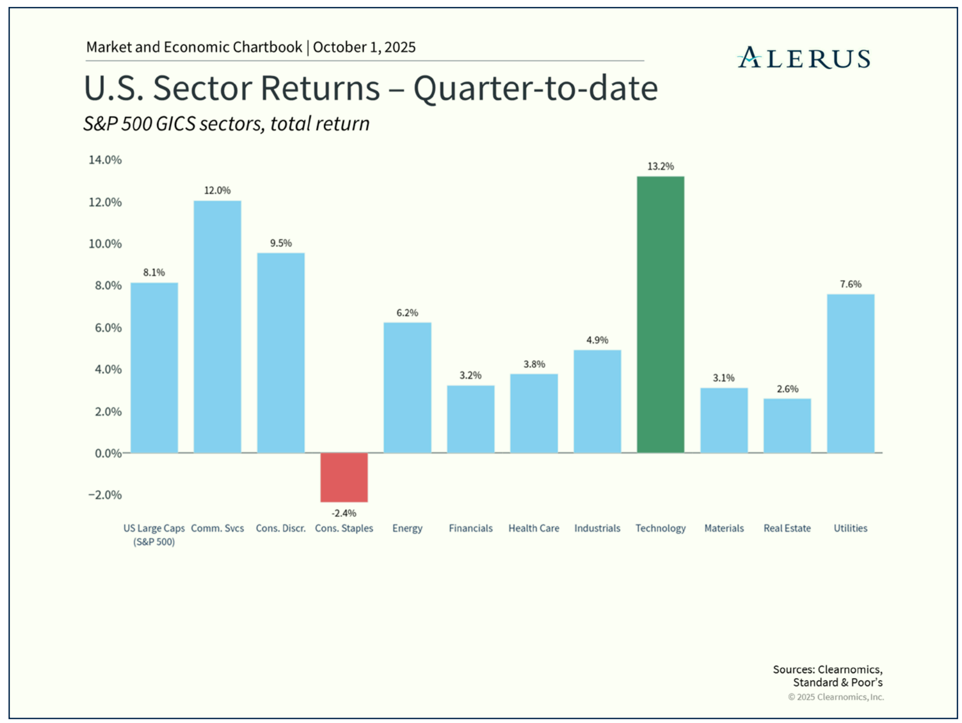
Agency mortgage-backed securities (MBS) returned 2.4 % in the third quarter, supported by yield carry and modest volatility. Despite continued runoff from the Fed's balance sheet and muted demand from regional banks, spreads remained relatively stable, reflecting consistent investor appetite and confidence in prepayment dynamics. While MBS slightly lagged other investment-grade sectors, they remained a reliable source of income and portfolio stability amid evolving monetary policy and mixed economic signals. The third quarter of 2025 capped a strong year for emerging market bonds, especially local currency debt which benefited from a weakening U.S. dollar. The dollar's decline of over 10% in the first half—its largest drop since 2003—created a tailwind for investors holding bonds denominated in currencies like the Brazilian real and Mexican peso. Both interest payments and the currency conversions worked in investors' favor, with local currency bonds delivering solid returns. Dollar-denominated emerging market bonds also posted positive returns, though their gains were more modest. Policy uncertainty in the U.S. led to increased flows into emerging market funds, providing additional support. The bottom line: 2025 has been a favorable year for emerging market debt, with local currency bonds performing well thanks to dollar weakness.

Municipal yields declined in the third quarter, driven by strong investor demand and lighter issuance. With attractive yields and a positively sloped curve, municipal bond funds saw robust net inflows totaling $19.7 billion for the quarter, including $5.8 billion in September alone. The Bloomberg Municipal Bond Index rose 3.0%, supported by improving technical conditions and a more constructive market tone. This performance reinforced the sector's appeal as a reliable source of tax-advantaged income, particularly in an environment marked by rate volatility and shifting monetary policy expectations.

Stocks: Lower Rates, Higher Stock Prices

The rally in stocks which began when Trump rolled back reciprocal tariffs in April, continued through the third quarter. The Standard and Poor's 500 stock index returned 8.1% and





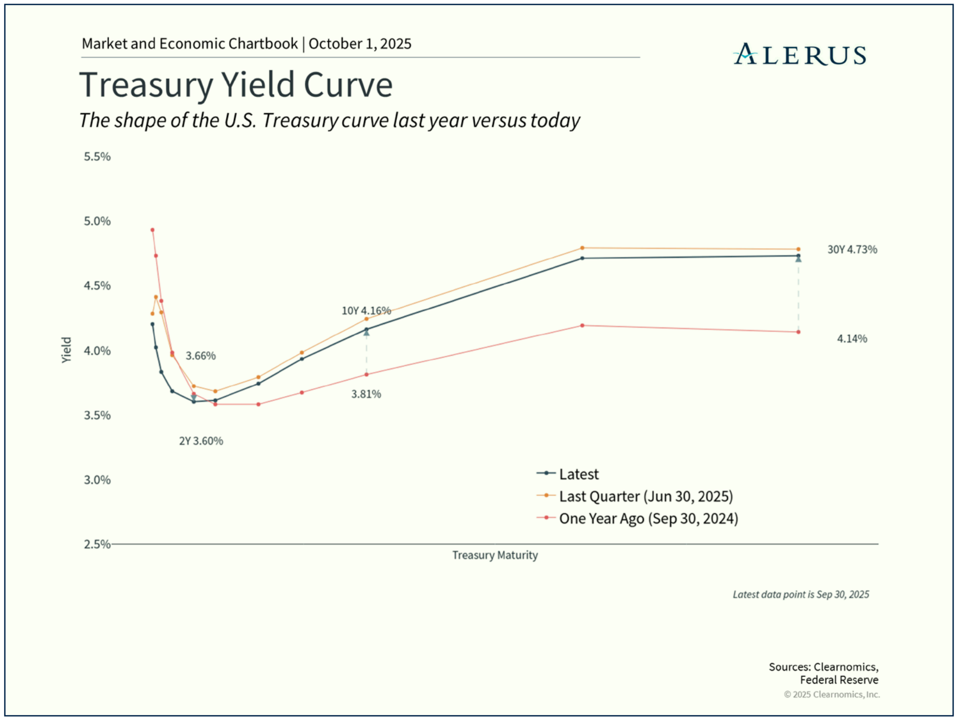
kept pace with international indices. Since bottoming on April 8, this has been one of the strongest rallies in market history. Improving economic metrics coupled with a softening labor market paved the way for the Fed to cut rates in September, the first time this year. This resulted in a "Goldilocks" environment for risk assets – an improving economy with lower rates, which drove stocks higher. Strong corporate earnings, sustained spending on artificial intelligence, and the passage of the One Big Beautiful Bill helped power the rally in stocks. While valuations are elevated, they are supported by solid profit growth, resilient margins, and a structural tilt toward technology and services in the index composition.

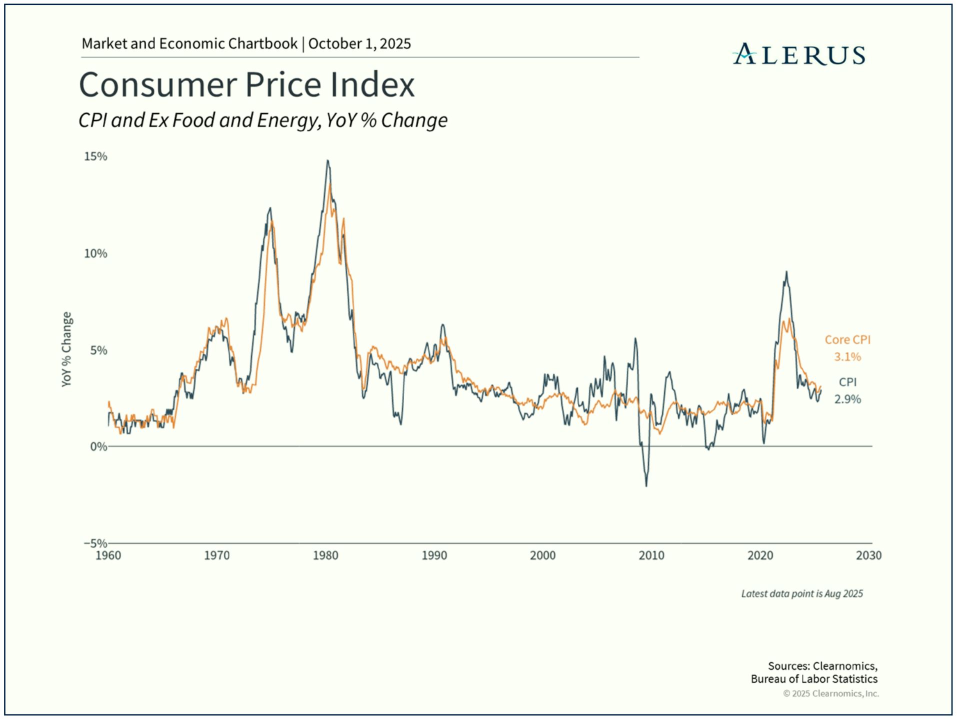
In a notable shift, small-cap stocks outperformed large-cap equities for the first time in years. Falling interest rates, improving economic data, and budget-driven tax incentives created a favorable backdrop for smaller, more leveraged companies. The Russell 2000 index of small company stocks reached a new high for the first time since 2021. Beneath the surface, high beta sectors such as technology, communications, and consumer discretionary led the charge, while defensive sectors such as healthcare and real estate lagged. Consumer staples was the only sector that ended the third quarter in negative territory. The Magnificent 7 index posted fresh highs, fueled by a 40% surge in Tesla and a nearly 38% gain in Google. In contrast, Accenture and Salesforce were the quarter's laggards, as investors questioned the resilience of consulting and software services in the face of accelerating artificial intelligence adoption. Style and size leadership also shifted: small value and large growth topped the leaderboard – an uncommon pairing, and something we have not seen in a while. Investors bid up the most cyclical stocks while maintaining an ongoing bid for secular growth.

International equities posted a strong quarter, led by emerging markets – particularly China. International developed markets underperformed U.S. equities, weighed down by a 1.1% decline in German stocks. A dovish pivot from the Fed, a stable dollar, and earnings momentum in AI-related names helped U.S. stocks. Meanwhile, European markets faced headwinds from tariff uncertainty – especially impacting the German auto sector – as well as political and budgetary concerns in France. Emerging market stocks outpaced U.S. performance, with Chinese equities surging more than 30%. Targeted government stimulus, increased investment in AI and innovation, and a more business-friendly policy stance from the government helped drive Chinese stocks.

Outlook: Cautiously Optimistic

With the labor market slowing, we expect the Fed to cut rates twice this year. Over the medium term, tariffs will likely act as a tax on the economy, dampening growth. Additional policies — such as tighter immigration rules and reductions in federal employment — could





further slow economic momentum. The Fed currently signals one additional cut in 2026, but these policy headwinds could force additional easing. That said, pro-growth elements of the One Big Beautiful Bill, particularly corporate tax reductions, should lower effective tax rates, boost cash flow, and support capital investment.

We remain overweight investment-grade corporate bonds for their attractive yield and carry profiles despite historically tight spreads. Our view reflects confidence in the sector's ability to generate compelling income while offering resilience through stable credit fundamentals. We are neutral on high yield given strong recent performance but see less relative value at current spreads. We favor government-backed mortgage securities and hold an overweight position in the sector. These securities offer compelling yield, while carrying no credit risk due to their explicit government guarantees. Limited issuance, driven by elevated mortgage rates and muted refinancing activity, continues to support valuations and technical stability. These positions are funded by an underweight in U.S. Treasuries, where relative value is less compelling.

Entering the fourth quarter of 2025, equity markets face a complex mix of resilient economic growth, cooling labor markets, and shifting policy. The traditional seasonality that favors equities during this period must be weighed against elevated valuations and geopolitical uncertainties. Historically, the fourth quarter has been favorable for equities, with November and December typically showing positive returns and lower volatility. The so-called "Santa Claus rally," and institutional rebalancing flows could provide tailwinds. However, investors should be cautious about relying too heavily on historical patterns, particularly when valuations are elevated and fundamental uncertainties remain.

Also, the fourth quarter typically sees investors reassess portfolio positioning ahead of year-end, leading to potential rotation among sectors and investment styles. The technology sector, which has been a significant driver of market returns in recent years, faces continued scrutiny over valuations and earnings growth sustainability. However, we expect the ongoing evolution of artificial intelligence applications and related infrastructure spending will remain key drivers of the overall market. Eventually, investors will demand evidence of profitable implementation and return on investment, but we don't expect that to be an issue until 2026. Should technology stocks or economic growth soften, traditional defensive sectors such as utilities, consumer staples, and healthcare may attract flows.

Both economic momentum and the potential for lower rates make for a favorable investment environment. Selecting among domestic, international-developed, and emerging market equities presents a complex decision for investors. There are tailwinds for all of them – Fed rate cuts, increased fiscal spending in Europe and favorable dynamics for Chinese equities. And finally, small cap stocks may be positioned to outperform large caps.

Risks

- Persistent policy uncertainty
- Sticky or higher inflation prompting Fed rate hikes
- Geopolitical tensions

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Sources: FactSet, Jefferies, Morning Star, Morgan Stanley, Goldman Sachs, Wall Street Journal, Bloomberg, Financial Times