



Global Government Bond Yields Rise Sharply

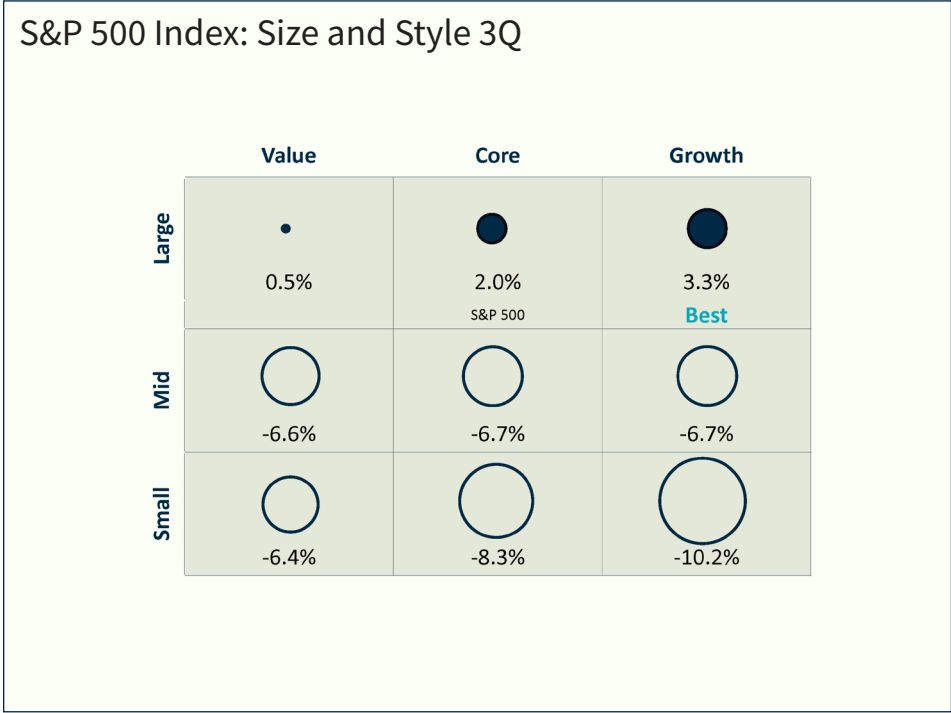
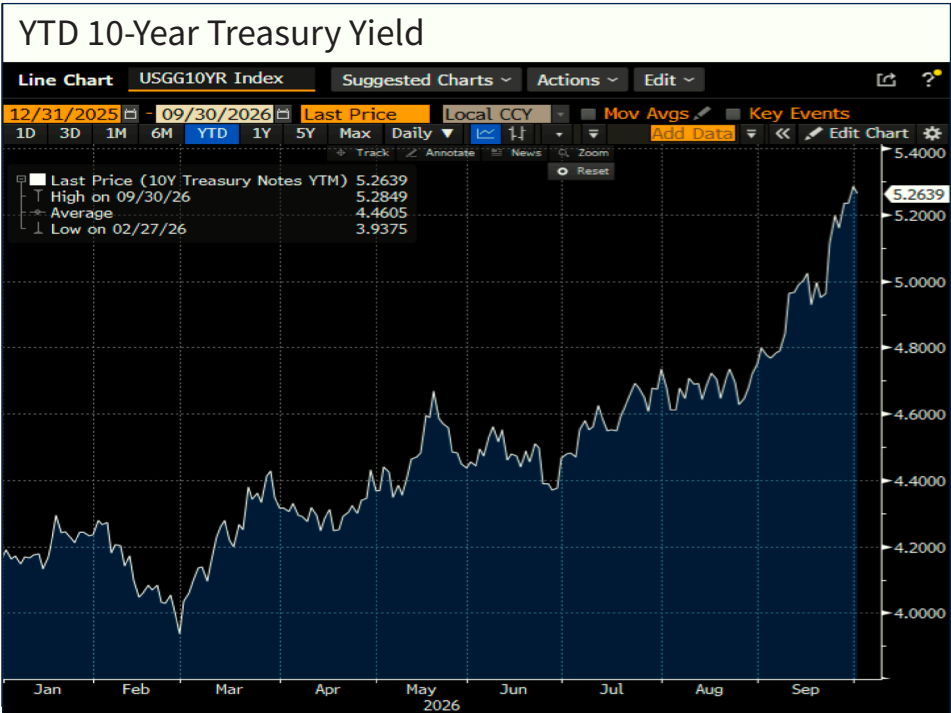
Long-term government bond yields rose sharply during the third quarter as investors adjusted to global central banks raising their benchmark interest rates. The yield on the U.S. 10-year Treasury climbed to 5.29%, its highest level since 2002, while yields in Japan, Italy, and the United Kingdom also moved meaningfully higher. Strong economic growth, persistent inflation concerns, rising energy prices, higher corporate debt issuance, and growing fiscal deficits contributed to the increase, prompting investors to demand higher compensation for holding longer-term government debt. The result was one of the most significant quarter-over-quarter increases in global bond yields in recent years.

Rising interest rates have real world consequences. They have raised borrowing costs for home buyers, businesses, and governments. Mortgage rates in the U.S. now sit above 7% making a sluggish housing market even more challenging. The U.S. government’s interest payments on the nation’s \$40 trillion debt have now exceeded \$1 trillion annually. This results in additional Treasury issuance to finance the already large deficit adding to pressure on yields to move higher. In addition to higher interest rates, consumers and businesses have had to deal with higher

gasoline and diesel prices thanks to the war in Iran and the damage done to refineries in the Middle East and Russia. Despite these problems, the U.S. economy keeps powering through with strong nominal GDP growth around 6%. Robust economic growth, resilient labor markets, and continued investment in artificial intelligence (AI)-related technologies helped support corporate earnings and stock market returns even in a rising interest rate environment.

Stocks: Large Cap Growth Leads as Breadth Narrows

Equity markets delivered positive returns during the third quarter, though leadership became noticeably more concentrated than earlier in the year. The Standard & Poor’s 500 Index gained 2.3%, supported by strong earnings growth and a narrow group of large-cap technology and AI-related companies. Rising bond yields, higher energy prices, and renewed inflation concerns weighed on more economically sensitive areas of the market, resulting in a sharp divergence between large- and small-cap stocks. Mid-cap equities declined 4.8%, while small-cap stocks, as measured by the Russell 2000 Index, fell 7.2%, as investors increasingly favored larger, higher-quality companies with stronger balance sheets, more resilient earnings streams, and greater pricing power.



Sector performance varied considerably across capitalization tiers. Energy once again led returns, benefiting from a sharp rise in oil prices and ongoing geopolitical tensions. Information technology and communication services also generated positive returns, driven by robust earnings growth and continued enthusiasm surrounding AI adoption, although higher interest rates prompted greater scrutiny of valuations. Style dispersion remained a defining feature of market performance. Within large caps, growth outperformed, driven by a small group of technology-oriented companies. In contrast, value outperformed growth across the mid- and small-cap universes, aided by strength in energy and other economically sensitive sectors. As yields moved sharply higher, investors increasingly favored larger, higher-quality companies with strong balance sheets, durable cash flows, and lower financing needs. This led to significant underperformance among smaller, more rate-sensitive companies.

Developed international equities gained 0.8% during the third quarter, while emerging markets declined 0.4%. Although resilient global economic activity continued to support corporate earnings, international markets faced a less favorable backdrop than the United States, as slowing growth across parts of Europe and Asia, rising government bond yields, and tighter financial conditions weighed on investor sentiment. A stronger U.S. dollar and higher U.S. interest rates created additional headwinds for emerging markets by pressuring local currencies and capital flows. Performance varied widely across regions, sectors, and investment styles, with markets more heavily exposed to energy and financial companies generally benefiting from higher commodity prices and rising interest rates, while more economically sensitive and growth-oriented areas lagged.

Similar to the U.S., investors increasingly favored quality companies with strong balance sheets, durable earnings, and pricing power as financing costs moved higher. Overall, international equities participated in the global advance but trailed U.S. large-cap stocks, reflecting weaker economic momentum, currency headwinds, and the global repricing of interest rates.

Bonds: Yields Rise Sharply Higher

Treasury yields rose sharply during the third quarter, particularly in September, with the 10-year Treasury yield increasing 82 basis points to 5.29%, its highest level since 2002. Investors grew increasingly concerned that inflation pressures could remain elevated due to higher energy prices, tariff-related supply chain disruptions, and a resilient U.S. economy. As a result, markets adjusted expectations for monetary policy and embraced a “higher for longer” interest-rate outlook. As expected, the Federal Reserve (Fed) raised its policy rate 25 basis points to a target range of 3.75% to 4.00%, its first increase since 2023. Policymakers reiterated their commitment to returning inflation to the 2% target and signaled that restrictive policy may be maintained until inflation shows further progress.

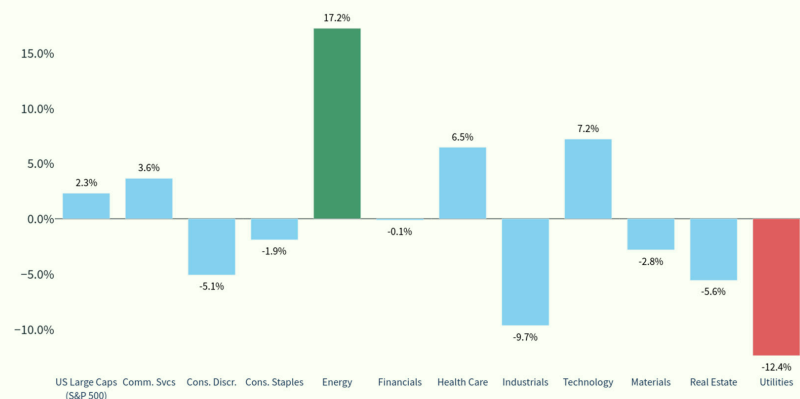
The Bloomberg U.S. Aggregate Bond Index declined 3.51% during the quarter and 2.91% year-to-date, as rising Treasury yields weighed on most fixed income sectors. Longer-duration bonds faced the greatest pressure, while spread sectors generally held up better. Although returns were negative, the increase in yields has improved the income and return potential available to fixed income investors.

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U.S. Sector Returns – Quarter-to-date

S&P 500 GICS sectors, total return



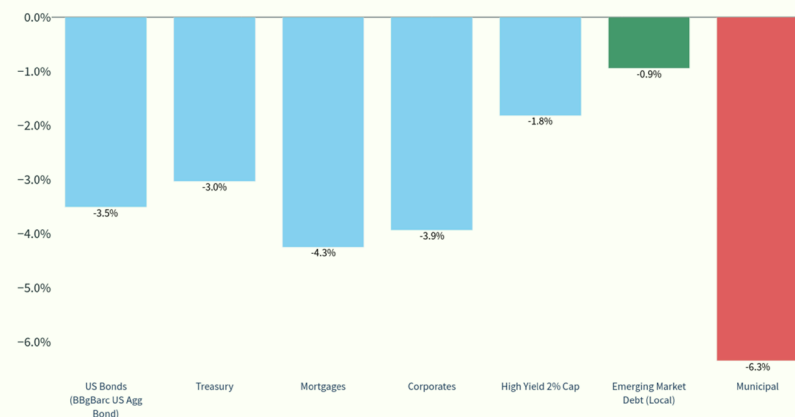
Sources: Clearnomics,
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Bond Sector Returns – Quarter-to-date

Bloomberg Barclays bond sectors, total return



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Investment-grade corporate spreads finished the quarter at +80 basis points, 6 basis points wider than in June. While higher Treasury yields drove negative returns, corporate fundamentals remained healthy, supported by strong balance sheets and manageable leverage levels. Tight spreads continue to reflect investor confidence in credit quality, though current valuations provide limited compensation for additional credit risk. High-yield bonds underperformed during the quarter as spreads widened 41 basis points and rising Treasury yields pressured returns. Despite the weakness, higher all-in yields continue to provide attractive income opportunities, while corporate fundamentals and default rates remain broadly supportive.

Emerging market debt delivered mixed results during the quarter but held up relatively well versus many domestic fixed income sectors. Higher Treasury yields and geopolitical uncertainty created headwinds, though attractive yields and generally stable, credit fundamentals helped support performance. Results varied by region as investors weighed local economic conditions and policy responses.

Agency mortgage-backed securities (MBS) underperformed most domestic fixed income sectors during the quarter as rising interest rates and elevated volatility weighed on performance. Higher mortgage rates continued to suppress refinancing activity and support prepayment stability, while attractive valuations and government backing remained positive characteristics of the sector. Municipal bonds faced a difficult quarter as rising Treasury yields, elevated issuance, and weaker market technicals weighed on performance. The Bloomberg Municipal Bond Index

declined 6.35%, underperforming many taxable fixed income sectors. Despite the weakness, municipal credit fundamentals remained stable, and higher yields improved the attractiveness of the asset class for long-term investors

Commodities: Oil Prices Rise as Geopolitical Risks Re-Emerge

Commodity markets rebounded sharply during the third quarter, with the Bloomberg Commodity Index gaining 16.0% as higher energy prices and renewed geopolitical tensions restored a meaningful risk premium across commodity markets. Escalating conflict in the Middle East and concerns surrounding global energy supplies pushed Brent crude oil back above \$100 per barrel, driving gains across much of the commodity complex.

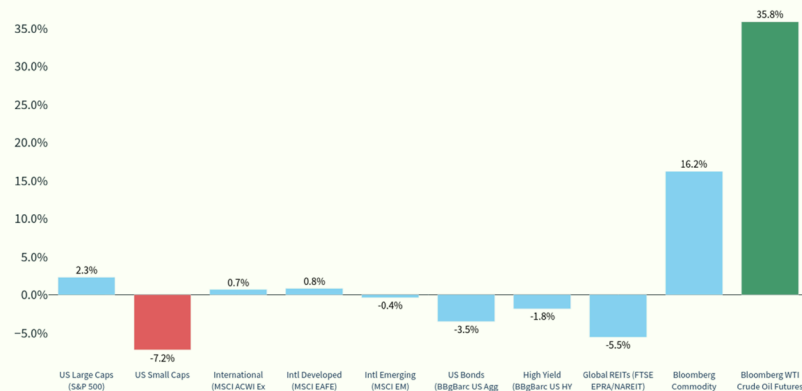
Energy was the strongest-performing segment, with the S&P GSCI Energy Index gaining 45.0% and crude oil prices surging 43.6%. Higher oil prices also contributed to renewed inflation concerns and pressure on global bond markets. In contrast, natural gas declined 7.6%, reflecting improved supply conditions despite periodic disruptions. Precious metals also recovered following second quarter weakness, with the S&P GSCI Precious Metals Index gaining 2.9% and gold rising 3.3%, supported by safe-haven demand, continued central bank purchases, and reserve diversification efforts. Industrial metals remained resilient as copper gained 8.0%, benefiting from ongoing investment in AI infrastructure, power-grid modernization, and broader electrification initiatives. Although manufacturing activity remained mixed across several regions, industrial metals benefited from sustained investment in technology and energy infrastructure.

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Major Index Returns – Quarter-to-date

Global asset class indices, total returns



Sources: Clearnomics, Standard & Poor's, MSCI, Russell, Bloomberg, FTSE
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YTD Diesel Price



Currency markets remained relatively stable during the quarter despite diverging central-bank policies, with the Japanese yen strengthening as investors increasingly priced in further Bank of Japan policy normalization while the U.S. dollar remained broadly resilient. Taken together, the third quarter highlighted two distinct drivers of commodity performance. Near-term returns were largely driven by geopolitical events and energy supply concerns, while long-term demand tied to AI, electrification, and infrastructure modernization continued to support industrial commodities. As a result, both cyclical and structural forces remained important drivers of returns across the commodity complex.

Outlook: Moderating Growth

With the war in Middle East likely to persist longer than we had anticipated and Ukraine becoming increasingly successful with its drone attacks on Russian energy infrastructure, we believe energy prices are likely to stay higher for longer, creating the potential for inflation to remain above central bank targets. As a result, the Fed may need to maintain restrictive monetary policy for longer than currently anticipated. Higher energy prices and higher interest rates should have a moderating impact on growth. The growth positive provisions of the One Big Beautiful Bill are also expected to fade in 2027, further slowing growth.

Despite slowing, we anticipate U.S. economic growth to remain resilient. The U.S. is supported by ample local production of oil and gas, continued investment in AI, and tax benefits for capital expenditures. The Trump administration's deregulation agenda should also bolster growth, particularly in the banking and financial services sectors. We are already seeing recovery in the jobs market. While inflation remains higher than the Fed's target, we expect it to come down as temporary impact of tariffs fades and higher interest rates bite into growth. Despite slowing growth, our base case remains one of economic expansion, and we continue to position portfolios to benefit from this environment.

We remain constructive on fixed income for the long term, as today's elevated yields provide attractive income and a strong foundation for future returns. While persistent inflation and a resilient economy could keep interest rates elevated in the near term, current yield levels

offer a meaningful cushion against additional rate volatility and create opportunities to lock in attractive income. Looking ahead, we believe fixed income is well positioned to deliver favorable risk-adjusted returns as inflation gradually moderates and monetary policy becomes more accommodative. We maintain a neutral view on investment-grade corporate bonds, as credit spreads remain relatively tight and provide limited compensation for additional credit risk. We remain modestly overweight in high-yield bonds and preferred stocks, where elevated yields and generally sound credit fundamentals continue to offer attractive income and return potential. Recent spread widening has been driven more by rising Treasury yields and market volatility rather than meaningful deterioration in issuer fundamentals, which remain healthy by historical standards. We favor agency MBS, which offers attractive yields with no credit risk, supported by explicit government guarantees. This overweight is funded by an underweight to U.S. Treasuries, where relative yields and income potential are less compelling. The municipal bond outlook remains favorable, supported by attractive yields and steady demand.

We anticipate a resilient U.S. economy and strong corporate earnings to offer a favorable environment for equities. We favor U.S. large-cap, high quality large-cap stocks which tend to outperform in an environment of slowing growth. The ongoing adoption of AI applications and related infrastructure spending remain key drivers of the overall market. Cyclical, small cap, and low-quality stocks tend to underperform under these conditions. International and emerging markets are more dependent on flows out of the Strait of Hormuz and likely to be pressured by a stronger dollar. However, attractive valuations and improving economic fundamentals should offer positive returns. Technology companies in markets such as South Korea, Taiwan, and China have also helped boost returns in emerging markets.

Risks

- Geopolitical tensions persist
- Extended full or partial closure of Strait of Hormuz further shocks energy markets
- Sticky or higher inflation prompt Fed rate hikes



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

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