FIXED INCOME PERSPECTIVES

A Periodic Strategy Review of Bond Market Trends and Economic Developments

December 2025

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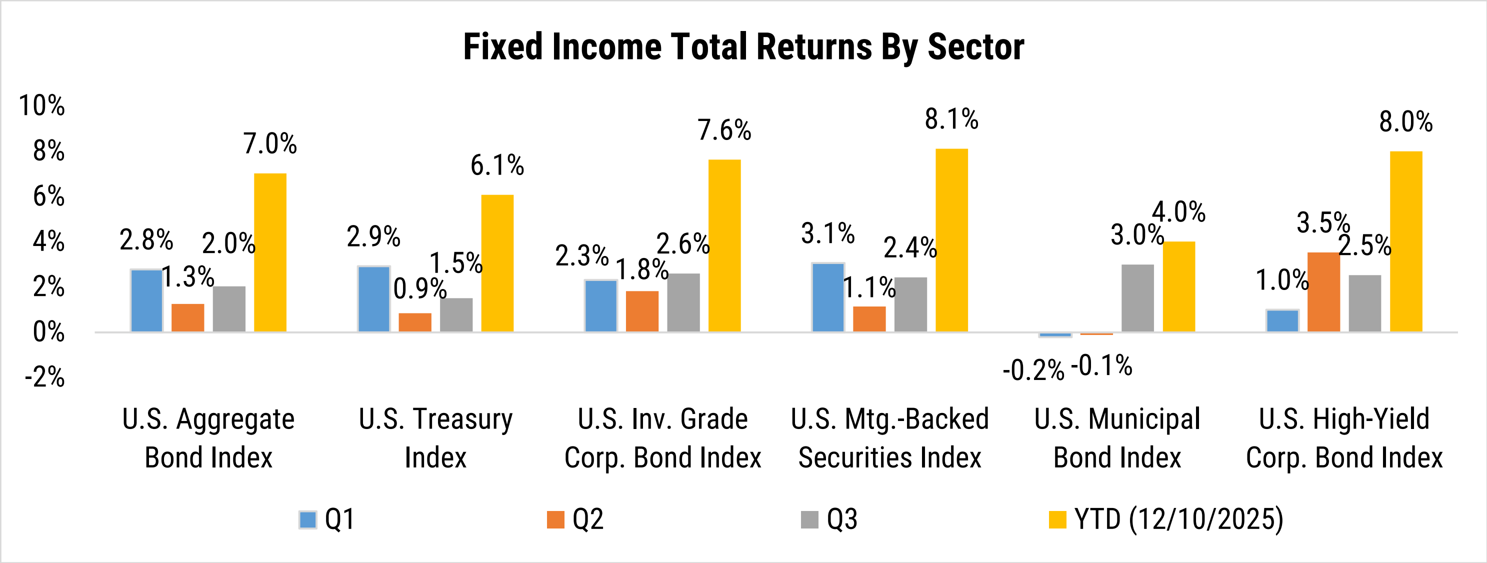
Another Step Toward Neutral

EquityCompass

While artificial intelligence has dominated coverage in the financial media this year, the impressive resurgence of fixed income has mostly flown under the radar. In the January edition of this report, we noted that *"bond market fundamentals point to a sustained recovery in the fixed income sector in 2025."* A durable rebound has indeed come to fruition, with the Bloomberg U.S. Aggregate Bond Index (AGG) generating an impressive year-to-date (YTD) total return of 7.03% through December 10. If the AGG closes December with a total return of 7.00% or higher, 2025 would mark only the fourth year in the past two decades where bonds have accomplished that feat. The AGG also appears likely to significantly outperform its 20-year compound average annual return of 3.00%.

Several factors have contributed to the AGG's stellar results, including above-average yields, stabilization in longer-term inflation expectations, and a recovery in credit spreads. But the most important driver of the AGG's performance in 2025 has been the resumption of rate cuts by the Federal Reserve (Fed). The overnight policy rate has been lowered by 75 basis points (bps) over the last three months, and the central bank's latest guidance calls for another 50 bps of easing through 2027. The Fed's pivot toward more neutral and less restrictive monetary policy has put downward pressure on Treasury yields across the curve, with the 10-year yield falling by 45 bps since the beginning of the year to 4.10%.

Fixed Income Sector Performance



Returns through 12/10/2025; Fixed income indices provided by Bloomberg; Source: Bloomberg Finance, LP

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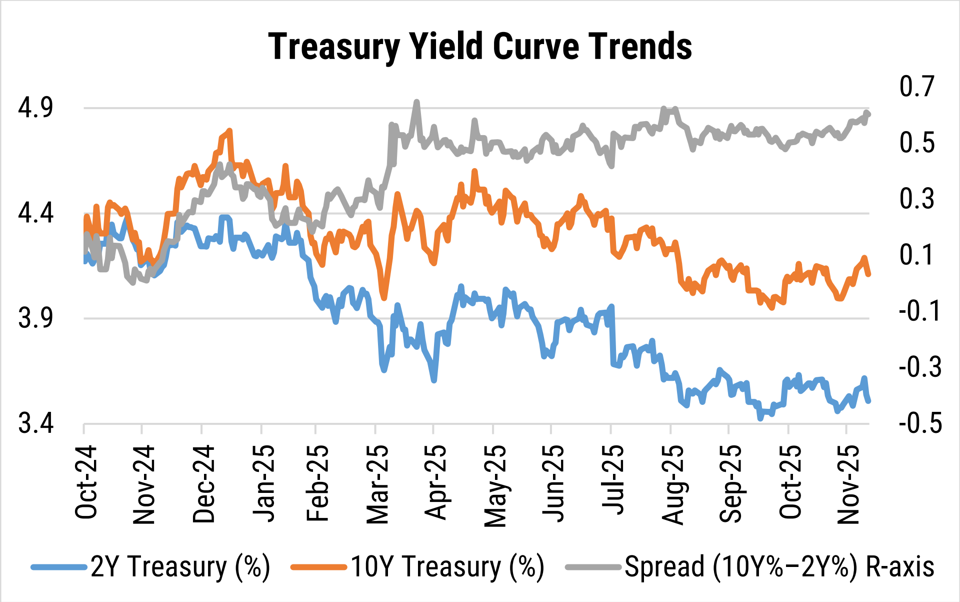
After experiencing a fair amount of tariff-related volatility through the first nine months of 2025, Treasury yields have settled into narrow, well-defined trading ranges near their YTD lows during the fourth quarter. The 10-year yield has largely been confined to a range of 4.0% to 4.2%, while the 2-year yield has mostly fluctuated between 3.4% to 3.6%. Likewise, the shape of the curve has remained remarkably stable, with the 2-year to 10-year yield-spread consistently hovering around 50 to 60 bps.

From a historical perspective, the Treasury yield curve has tended to steepen significantly during Fed easing cycles. Although the 2-year to 10-year Treasury yield differential has widened by 55 bps since the first rate cut for this cycle in September 2024, this spread remains well below its 30-year average of 96 bps. Assuming the Fed continues to gradually lower rates over the next two years in accordance with its latest forward guidance, the Treasury yield curve should continue to steepen, led by lower short-term rates.

Treasury Yield Curve



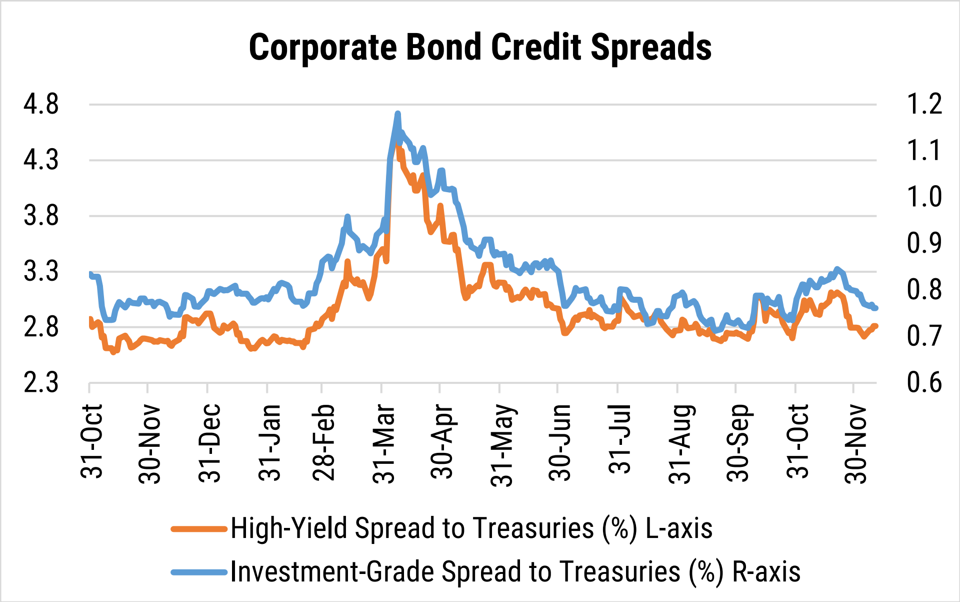
Source: Bloomberg Finance, LP

Past performance cannot and should not be viewed as an indicator of future performance.

Credit Spreads

After spiking in April on concerns over the potential ramifications of high tariffs on the U.S. economy, corporate bond credit spreads have nearly fully recovered to their pre-tariff levels. **Greater certainty surrounding U.S. trade policy justifies some of this sharp reversal, but lingering risks to gross domestic product (GDP) growth, employment, and inflation suggest that spreads may have tightened to a greater extent than warranted by economic fundamentals.**

The consensus outlook from Bloomberg's most recent survey of economists published on November 21 envisions a brief period of stagflation in late 2025/early 2026, followed by stronger growth and lower inflation as next year progresses. Economists project that GDP growth will decelerate in the fourth quarter as inflation moves higher. The consensus forecast shows real GDP growth sliding from 2.0% over the first three quarters of 2025 to 1.0% in the fourth quarter. The Consumer Price Index (CPI) is expected to remain on a slight upward path, rising from 2.9% in September to 3.0% by year-end. Further deterioration is projected for the unemployment rate—the survey forecasts at 4.5% in December—which would represent a 50-month high. While it is important to note that the consensus outlook envisions a further slowdown in growth rather than an outright recession, the margin for error against a more severe economic downturn appears to have narrowed, despite the abnormally low level of credit spreads.



Source: Bloomberg Finance, LP

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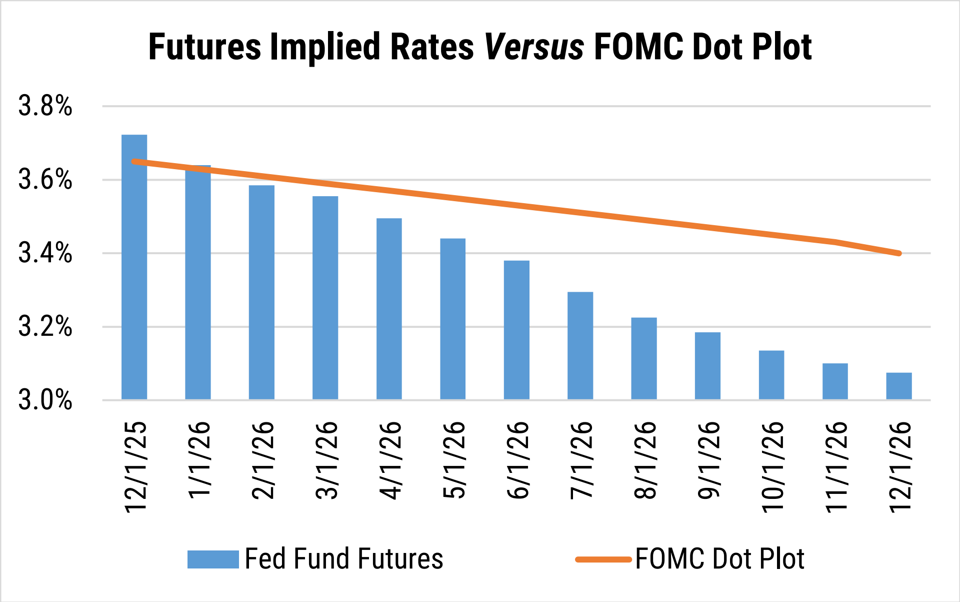
Federal Reserve Monetary Policy

With the labor market showing signs of deterioration and inflation holding under 3.0%, the Fed took another step toward less restrictive monetary policy at the December 10 Federal Open Market Committee (FOMC) meeting. The overnight funds rate was cut by 25 bps, with the target range now residing at 3.50% to 3.75%. Since mid-September, the Fed's primary policy rate has been lowered by a cumulative 75 bps.

The Fed's updated dot plot incorporates further rate cuts over the next two years, with the policy rate reaching the target neutral level of 3.0% by the end of 2027. Importantly, there were no changes to the dot plot compared to September, with the Fed's forward guidance continuing to foreshadow only one 25 bps rate cut per year in both 2026 and 2027. Interest rate futures reflect the divisions within the FOMC, implying a 20% probability of a 25 bps rate cut in January. However, futures still anticipate a slightly more aggressive easing cycle next year compared to the Fed's latest forward guidance. For calendar year 2026, futures are pricing in 50 bps of rate cuts, compared to the 25 bps shown in the Fed's dot plot.



As of 12/10/2025; Source: Bloomberg Finance, LP

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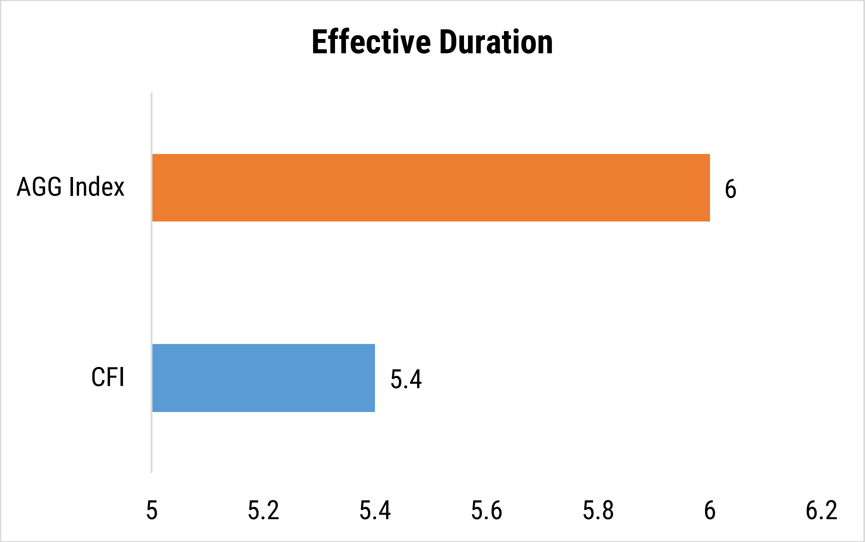
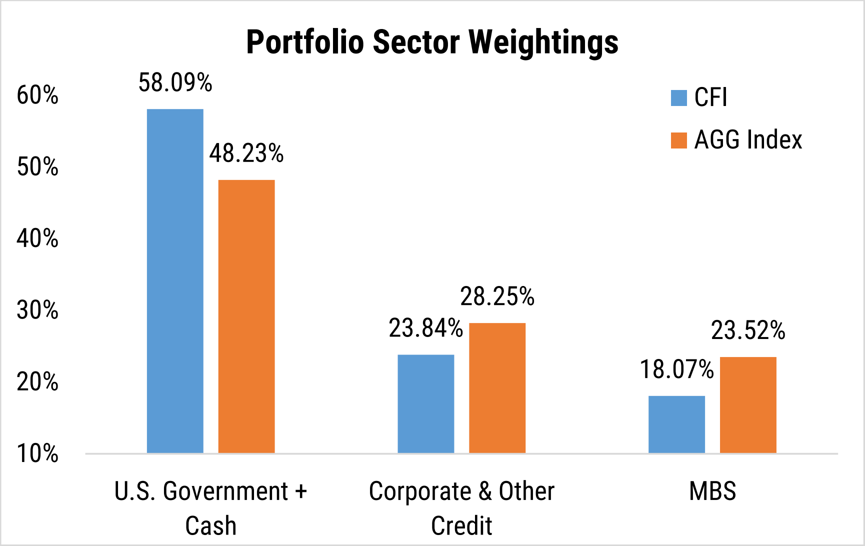


As of 12/10/2025; Source: FactSet Data Systems, Inc. and Bloomberg Finance, LP



As of 12/10/2025; Source: FactSet Data Systems, Inc. and Bloomberg Finance, LP

Core Fixed Income Portfolio (CFI) Statistics

Compared to the AGG, the Core Fixed Income Portfolio offers a similar yield, higher credit quality, and a shorter duration. As a point of reference, the yield to maturity of the AGG as of December 10 was 4.4%. To address the risk that credit spreads could materially widen if the economy underperforms expectations, CFI maintains a higher credit quality profile relative to the AGG. Compared to the benchmark, CFI holds an overweight to the combination of Treasuries and cash of 10%, with a commensurate underweight to corporate bonds and other sectors with higher credit risk and interest rate risk exposures. The portfolio's half-year shorter duration on a relative basis is a function of curve positioning, given CFI's overweight to the intermediate-term (3-7 year) segment of the curve and underweight to the long-term (10-year+) duration bucket.

Fixed Income Market Review

- The fixed income market is poised for its strongest annual performance since 2020, fueled by the Fed’s ongoing shift toward less restrictive monetary policy.
- As the fed funds rate approaches a more neutral level, Treasury yields remain locked in narrow trading ranges near their year-to-date lows.
- Corporate bond spreads have nearly fully recovered after spiking last spring, as uncertainty regarding U.S. trade policy has dissipated.
- The Fed has reduced short-term interest rates by 75 bps since mid-September, and its latest forward guidance incorporates additional rate cuts over the next two years.
- Defensive positioning in the Core Fixed Income Portfolio remains appropriate given the unsettled macro environment and lingering downside risks.

The high-frequency data has varied considerably over the past two months, showing weakness in October in conjunction with the federal government shutdown and recovery in November once the impasse concluded. The early December trends have also been encouraging, with the majority of indicators showing positive results for the first week of the month.

In addition to the disruption in government services, October's relatively poor showing in the high-frequency data may have been partly attributable to the recent resurgence in consumer inflation. After falling to a 54-month low of 2.3% in April, the CPI moved steadily higher over the next five months. For September, CPI added 0.3% (consensus 0.4%) month-over-month (m/m) and increased by 3.0% (consensus 3.1%) year-over-year (y/y). Core CPI showed similar results, with advances of 0.2% m/m (consensus 0.3%) and 3.0% y/y (consensus 3.1%).

High-Frequency Economic Data Monitor

High-Frequency Indicators	Current Reading	-1 Week	-2 Weeks	-3 Weeks	1 Week Pct	2 Week Pct	3 Week Pct
U.S. Crude Rotary Rig Count	407	419	417	414	-2.9%	-2.4%	-1.7%
Raw Steel Production	1,736	1,761	1,745	1,758	-1.4%	-0.5%	-1.3%
MBA U.S. Purchase Index	186.1	181.6	168.7	172.7	2.5%	10.3%	7.8%
JRI Same Store Sales Monthly (YoY)	6.4%	6.0%	6.0%	5.9%	0.4%	0.4%	0.5%
Department Store YOY % Change (MTD)	0.0%	-0.4%	-0.1%	-0.2%	0.4%	0.1%	0.2%
Initial Jobless Claims	191.0	218.0	222.0	228.0	-12.4%	-14.0%	-16.2%
Continuing Jobless Claims	1,939.0	1,943.0	1,953.0	1,946.0	-0.2%	-0.7%	-0.4%
N.Y. Fed Weekly Economic Index (WEI)	2.3	2.2	2.3	2.0	6.9%	0.0%	19.5%
U.S. TSA Checkpoint Numbers	3,133,924	2,616,886	2,602,426	2,631,038	19.8%	20.4%	19.1%
Chicago Board Options Exchange (VIX)	15.7	16.4	23.4	19.8	-4.0%	-33.0%	-20.8%
IG Corp. Credit Default Spread (CDX)	50.5	51.1	54.5	53.4	-1.1%	-7.3%	-5.3%

Data as of 12/5/2025. Green denotes positive trend; red denotes negative trend.
Source: Bloomberg Finance, LP

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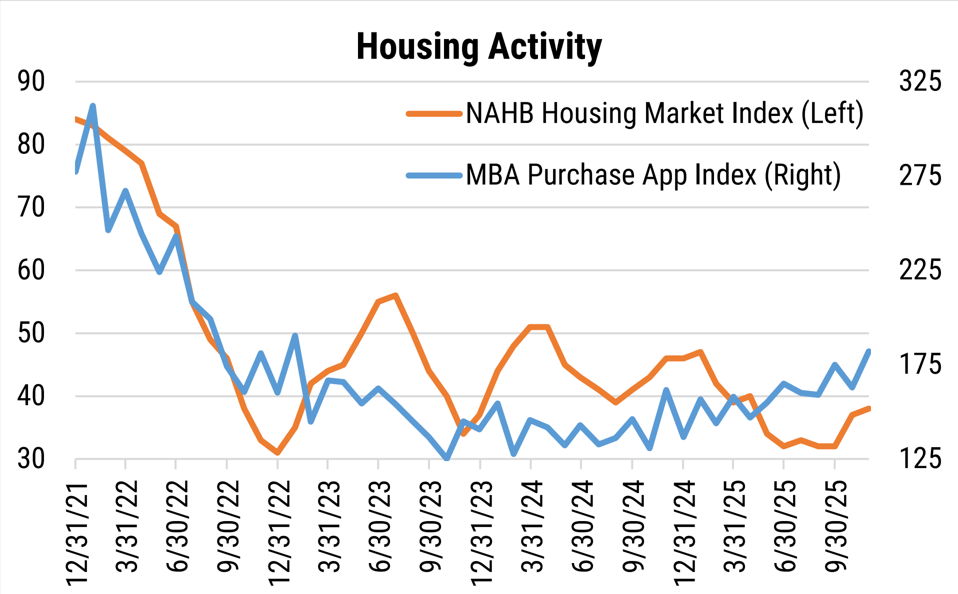
Mortgage Applications

Housing activity has shown some tentative signs of improvement but remains at historically low levels, due to the persistent challenges of inadequate supply and poor affordability. The NAHB Housing Market Index rose to a seven-month high of 38 for November but was lower by 17% on a y/y basis. While the response to the lowest mortgage rates in three years has been relatively muted, mortgage applications for home purchases have generally trended upward in recent months. Since the end of July, the MBA Mortgage Purchase Index has climbed by 15% to 182. Existing home sales have been bouncing around the four million level for the past 24 months—a trend that continued in October. For the month, existing home sales totaled 4.1 million at an annualized rate, which resulted in a minor increase of 1.2% m/m.



Source: Bloomberg Finance, LP

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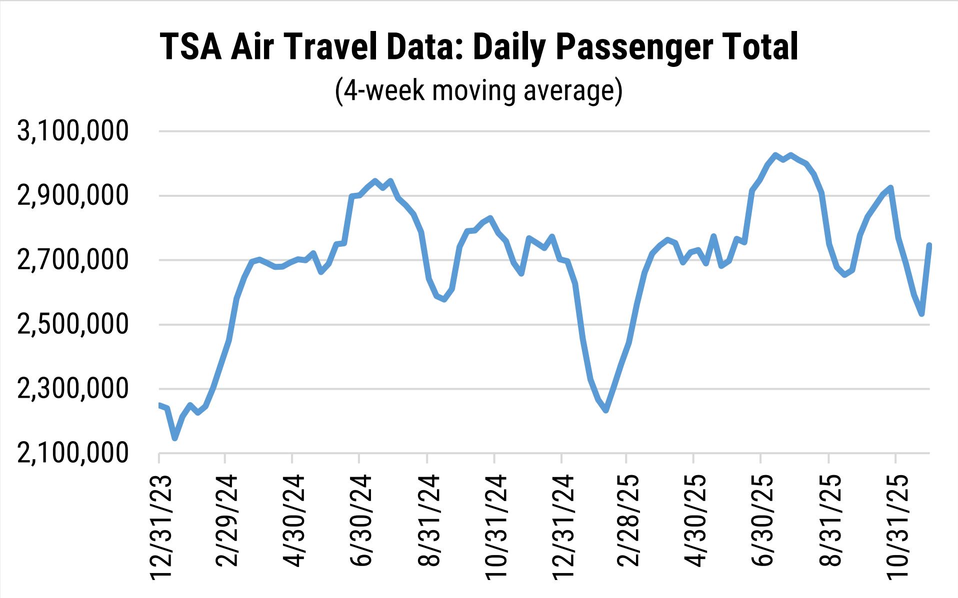
In a year characterized by multiple economic headwinds, consumer spending has shown remarkable resiliency. Through September, real personal spending on a y/y basis held steady at around 2.0%. While lower income consumers have felt the pinch from rising prices, consistent demand from the higher income cohorts has propelled the economy forward.

This dynamic is particularly evident in the air travel data, which has remained robust this year despite the disruptions resulting from the prolonged government shutdown. Compared to last year, air passenger volume has exceeded 2024's record pace by nearly 1%. The vibrant travel and leisure sector has provided a helpful boost to the broader economy, offsetting at least a portion of the persistent weakness in the housing and manufacturing sectors.

Air Travel By Total Passengers



Source: Bloomberg Finance, LP

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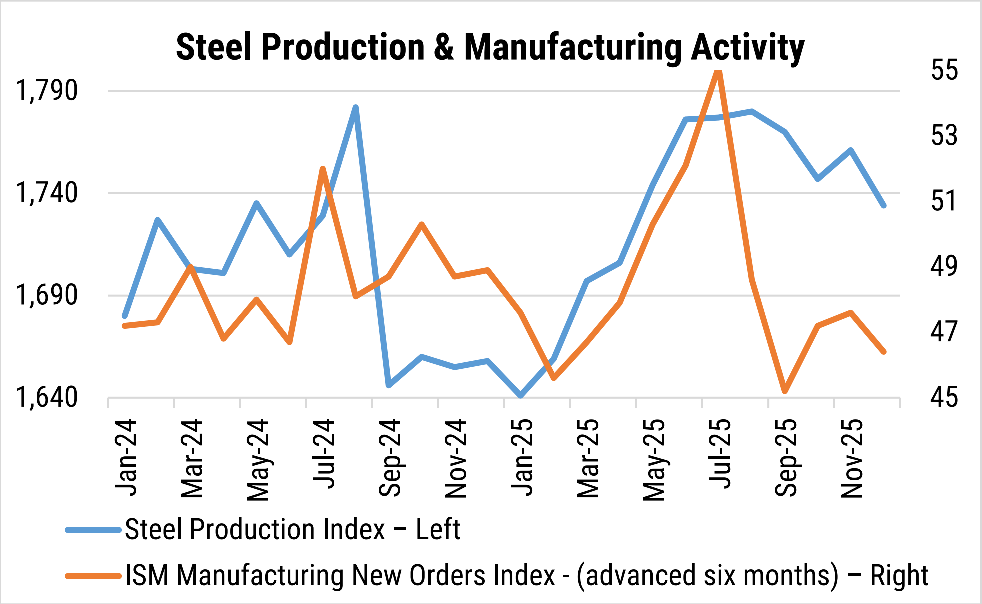
Steel Production

The initial boost to domestic manufacturing from tariffs on imported goods appears to be fading, in response to softer demand and higher input costs. The ISM Manufacturing Index remained below 50 for the ninth consecutive month, dropping by 1% to 48.2. New Orders slid by two points to 47.7, while Price Paid rose by 0.5 points to 58.5. Since the New Orders component often leads changes in steel output by around six months, the recent decline in demand for manufactured goods may foreshadow more substantial cuts to steel production over the next several months.

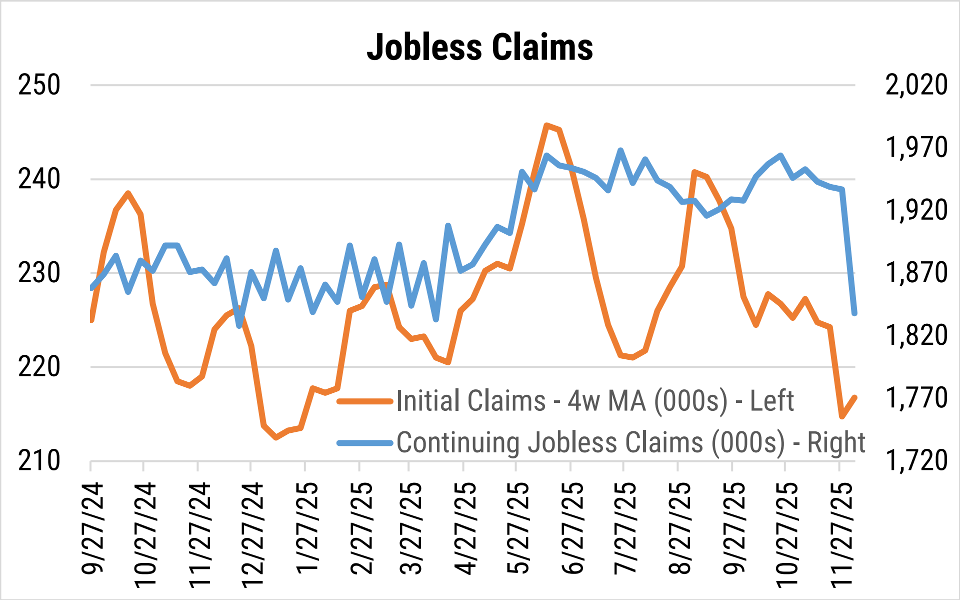


Source: Bloomberg Finance, LP

According to the ADP employment data, private sector job growth has slowed markedly since the implementation of broad-based tariffs in April. Over the past seven months, the average monthly change in private payrolls has dropped to +13,000, compared to +119,000 over the first four months of the year. After a solid rebound of +47,000 in October, private payrolls contracted in November, falling by -32,000 for the month. Including November's decline, the three-month moving average has fallen into negative territory at -5,000 per month.

While hiring appears to have stalled, layoffs have not yet accelerated meaningfully based on the latest jobless claims data. To the contrary, filings for unemployment insurance have declined in the fourth quarter, with employers apparently content to retain existing workers until economic visibility improves. Continuing claims suddenly plunged at the end of November, but the reported number was likely temporarily suppressed due to the Thanksgiving holiday. The less volatile four-week moving average for initial claims data has also been on a downward trend but ticked higher by 2,000 for the week of December 5 to 216,750.

Jobless Claims



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Economic Data Review

- High-frequency economic indicators languished during the government shutdown but have rebounded over the past three weeks.
- The latest round of housing data showed only minor improvements despite lower mortgage rates, amid ongoing affordability and supply challenges.
- Discretionary spending by upper-income consumers has remained robust, with air passenger volume on pace for a record high in 2025.
- Softer demand for U.S. manufactured goods may foreshadow weaker steel production in the coming months.
- Activity in the labor market remains sluggish, with a pronounced slowdown in both hirings and layoffs.

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About the Author

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Senior Portfolio Manager

Jim joined EquityCompass in July 2019. He is a Senior Portfolio Manager for the Core Fixed Income Portfolio, Municipal Income Enhanced Portfolio, and co-manager of the High-Dividend Portfolio. Prior to joining the portfolio management team, Jim served as the Chief Fixed Income Strategist at Stifel, Nicolaus & Company, Incorporated for 12 years. At Stifel, Jim created investment portfolio and risk management strategies for the firm's institutional fixed income clients. He also managed a $3 billion bond portfolio for Stifel Bank. Previously, he spent five years at Legg Mason as a fixed income strategist and 13 years at the Federal Deposit Insurance Corporation (FDIC) in bank supervision. His FDIC career focused on the credit analysis of bank balance sheets and the risk profile of innovative credit market instruments, including corporate bonds, mortgage-backed securities, and derivatives.

Jim has a B.S.B.A. in Finance from West Virginia University. He is also a CFA charter holder and member of the CFA Society Baltimore.

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About EquityCompass

EquityCompass Investment Management, LLC ("EquityCompass") is a Baltimore-based equity investment management team that provides portfolio strategies with respect to assets over $5.7 billion.[1]

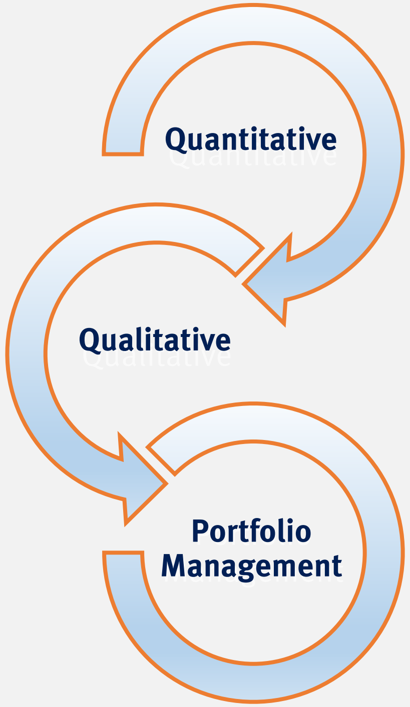
At EquityCompass, our mission as an asset management company is to provide investment solutions that address the needs of clients accumulating, mitigating risk to, and decumulating wealth. We aim to accomplish these goals with an organization culture that prizes intellectual honesty, open dialogue among colleagues, and a commitment to continually improve ourselves and the investment process.

Extensive Investment Experience

- Investment team led by Richard Cripps, CFA – former Managing Director of Portfolio Strategy at Stifel and former Chief Market Strategist and Co-Chairman of the investment committee at Legg Mason Wood Walker
- Senior members include Robert Hagstrom, CFA, as Chief Investment Officer and Chris Mutascio as Senior Managing Director – both with 20+ years of investment experience
- Publishing investment research since 2001
- Offering investment portfolios on the Stifel platform since 2006

Research-Driven, Risk-Managed Portfolio Strategies

- Incorporates fundamental, technical, and behavioral insights evolving from original research by EquityCompass professionals
- Portfolios are designed to maximize expected returns by focusing on stock selection while incorporating rigorous risk management strategies
- The investment team collaborates to leverage ideas, research, and expertise in making investment decisions on all strategies



Rigorous empirical testing to identify favorable risk-adjusted investment insights

Experienced qualitative analysis for final investment selection

Focused and disciplined portfolio decision-making

(1) Total assets combines both Assets Under Management and Assets Under Advisement as of November 30, 2025. Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non fee-paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

Disclosures

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Description of Benchmark(s): **The MBA (Mortgage Bankers Association) Purchase Index** is a weekly report of mortgage loan applications based on a sample of 75% of U.S. mortgage activity. Analysts consider the report to be a leading indicator of housing market activity. The **Bloomberg U.S. Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). The **Bloomberg U.S. Treasury Index** measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting. The **Bloomberg U.S. Mortgage Backed Securities (MBS) Index** tracks fixed-rate agency mortgage backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage. The **Bloomberg U.S. Corporate Bond Index** measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers. The **Bloomberg U.S. Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on EM country definition are excluded. The **Bloomberg U.S. Municipal Bond Index** is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year. The **S&P 500® Index** is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

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The **Chicago Board Options Exchange (CBOE)** created the VIX (**CBOE Volatility Index**) to measure the 30-day expected volatility of the U.S. stock market, sometimes called the "fear index." The VIX is based on the prices of options on the S&P 500 Index and is calculated by aggregating weighted prices of the index's call and put options over a wide range of strike prices. **The Institute of Supply Management (ISM) Manufacturing Purchasing Managers Index (PMI)** is based on data compiled from monthly replies to questions asked of purchasing and supply executives in over 400 industrial companies. For each of the indicators measured, this report shows the percentage reporting each response, the net difference between the number of responses in the positive economic direction and the negative economic direction and the diffusion index. **The Raw Steel Production Index** measures the real output of all relevant establishments located in the United States, regardless of their ownership, but not those located in U.S. territories. The **Weekly Economic Index (WEI)** provides a signal of the state of the U.S. economy based on data available at a daily or weekly frequency. The WEI is an index of ten indicators of real economic activity, scaled to align with the four-quarter GDP growth rate. It represents the common component of series covering consumer behavior, the labor market, and production. The **Manufacturing ISM Report** is based on data compiled from monthly replies to questions asked of purchasing and supply executives in over 400 industrial companies for each of the indicators measured: New Orders, Backlog of Orders, New Export Orders, Imports, Production, Supplier Deliveries, Inventories, Customers Inventories, Employment, and Prices. The **Conference Board Leading Economic Index** is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables. The **NAHB/Wells Fargo Housing Market Index (HMI)** is based on a monthly survey of NAHB members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months as well as the traffic of prospective buyers of new homes. The **credit default swap index (CDX)** is a benchmark financial instrument made up of credit default swaps that have been issued by North American or emerging market companies. A credit default swap is an over-the-counter derivative contract that offers one counterparty protection against a credit event, such as the default or bankruptcy of an issuer. It can be thought of as insurance in the financial world. The credit default swap index tracks and measures total returns for the various segments of the bond issuer market so that the overall return of the index can be benchmarked against funds that invest in similar products. **Gross domestic product (GDP)** is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country's economic health. All benchmark returns are shown on a total return basis and assume that all cash distributions, such as dividends, are reinvested. The volatility of the indices identified in this report may be materially different from the volatility of the model portfolios presented by EquityCompass. Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment.

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