MONTHLY
Portfolio Pulse

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Being Normal

Investor attention has shifted to interest rates as the 10-year U.S. Treasury yield moved from 4.63% to 5.24% over the span of six weeks – its highest level in nearly 20 years. Concerns are mounting that the recent jump reflects investor dissatisfaction over higher debt loads. We think it is more driven by fundamentals – and is part of the normalization process that began in 2021, after a decade-plus of zero interest rate policy (ZIRP). Economic growth has been strong and inflation is stubborn, forcing the Federal Reserve to hike rates in September. But despite higher rates, ongoing solid fundamentals keep us tactically overweight equity risk.

Just be normal! While often a demand shouted at parents by their teenage kids when around friends, investors are a bit more skittish about the prospect as it pertains to the interest rate backdrop. But prior to the past 20 years of ZIRP-influenced financial markets, a 5.24% 10-year U.S. Treasury yield was "normal" (that is to say the average) in the decade prior (1995-2005) – and the floor for nearly four decades before that (back to 1967). We believe the continual trend upward that started in 2021 is a reflection of the slow removal of the ZIRP influence – initially, the Fed getting off the zero bound; more recently, the continued discussion around reducing the size of the Fed's balance sheet – with the latest jump largely driven by the strength of the U.S. economy and ongoing inflationary concerns. This is not to say that higher rates cannot affect equity-market pricing – all else equal, higher rates can lead to lower valuation levels assigned to current earnings. But helping to offset the effect of any valuation reductions is the continued strength in corporate fundamentals, which will be in the spotlight as 3Q earnings season gets going in earnest this week.

Further rate increases ahead? We believe we remain in a period of interest rate volatility as investors adjust to the confluence of accelerating economic growth, stubborn inflation and a Fed deciding on how to react to it all. While we do not expect the Fed's September rate hike to represent the start of another long and drawn-out rate-hiking campaign (like we saw in 2022/2023), we do see the possibility of a couple more hikes as the Fed waits for the disinflationary trend seen prior to the Iran conflict to return. Should we see modestly higher rates from here – driven by fundamentals – we would expect only a small potential impact on equity markets. The risk (relatively muted in our opinion) is that we see a bigger rate jump that's clearly driven by government debt-load concerns.

Or will we get near-term relief? We view it just as likely that we hit a near-term peak in interest rates (see Exhibit 1). The most recent inflation report came in below expectations – as did the most recent jobs report, with wage growth continuing its downward trend. Should this continue, the Fed may not need to raise rates much further and bond investors may find a 5.25% 10-year yield increasingly attractive. A near-term cap on interest rates could pave the way for the start of a "Santa Claus rally" after the midterms.

Embrace normal. We are also finding the 5.25% 10-year yield increasingly attractive – and recently started reducing our Fixed Income tactical underweight. But we also think equities – notably U.S. equities – can continue to do well in the current environment.

Exhibit 1: A focus on interest rates
We believe financial markets will be most influenced by the path of interest rates over the coming months.

Downside Risk Case: **Rates Still Weird**	Base Case: **Being Normal**	Upside Risk Case: **Rate Cap**
15% Probability	*70% Probability*	*15% Probability*
Interest rate movements don't align with underlying fundamentals, implying investors are spooked by debt levels. Higher interest rates overwhelm ongoing fundamental strength, causing an equity-market drop.	Higher interest rates simply reflect normalization after 20 years of being influenced by zero interest rate policy. Current fundamentals – including strong earnings growth – offset the headwind of higher rates, allowing equity gains.	Inflation cools and U.S. Treasurys find buying interest, capping the 10-year yield around 5.25%. Fewer (if any) additional Fed rate hikes usher in the start of a "Santa Claus rally" post-midterms.

Macro Outlook

Growth

Despite (or perhaps causing) higher interest rates, economic momentum continues at a healthy pace. The Services Purchasing Manager Index (PMI) is highly correlated to GDP (see Exhibit 2) and is signaling roughly 4% third-quarter GDP growth. Meanwhile the Manufacturing PMI has remained in expansion for nine straight months. All said, economic metrics support the view that the economy continues to offer a strong foundation for financial markets – certainly on the business side.

On the labor front, the most recent payroll report came in on the light side and unemployment ticked slightly higher to 4.2% (from 4.1%). But unemployment claims remain low and trending downward and consumer spending remains solid. Meanwhile, consumer credit remains in a modest upward trend and credit-card delinquencies have been falling since March 2026. Headlines around "buy now, pay later" abound, but research suggests that represents just ~0.1% of credit.

Inflation

Inflation remains sticky but not unanchored. While 10-year inflation expectations (as judged by (break-even inflation rates) have moved cyclically higher since July (to ~2.35%), they remain well below their earlier-year highs (over 2.5%). The most recent softer-than-expected Core PCE reading (3.0% year-over-year vs. 3.3% expected) and the softer jobs report (including continued wage-growth slowdown) offered more hope that disinflation has slowed but is not reversing.

One key risk within the energy complex is the recent divergence of diesel prices as compared to regular gas (see Exhibit 3) – the former outpacing the latter by 16% since the 4th of July. The two fuels act on core inflation in opposite ways – while higher gas prices can often reduce demand for other goods given consumer-budget constraints, higher diesel prices – an essential transportation cost – can push the price of goods higher. The main issue is not oil supply. It's refining capacity – and that will likely take time to correct.

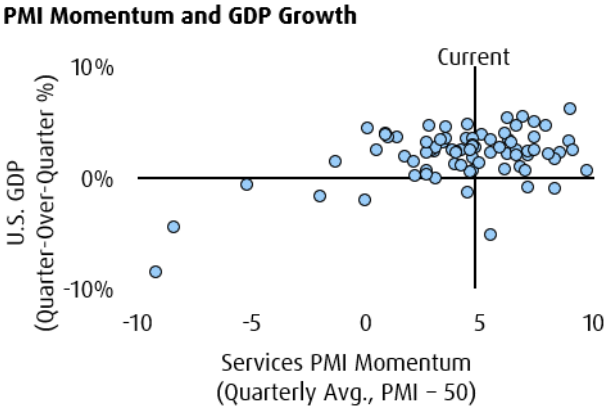
Monetary Policy

The Fed hiked rates for the first time since 2023 in September and markets are pricing in at least one more hike by the end of the year. The Fed appears fully focused on inflation over employment concerns at this point, with zero Fed officials seeing unemployment risks in their most recent survey (see Exhibit 4). Recent Fed comments suggest a likely pause at its next announcement on October 28 – but its December 9 meeting remains very live.

We agree it is unlikely that we will get another rate hike in October (just one week before the midterm elections), while the prospects for another rate hike in December will depend on the path of inflation over the intervening period. For now, we believe the Fed mindset is one of maintaining restrictive policy for longer rather than materially hiking rates further. At the current 4% policy level, the Fed is already in restrictive territory. And Fed policy really can't do a lot to temper the current inflation drivers of oil and AI – only more supply can.

Exhibit 2: Still running strong

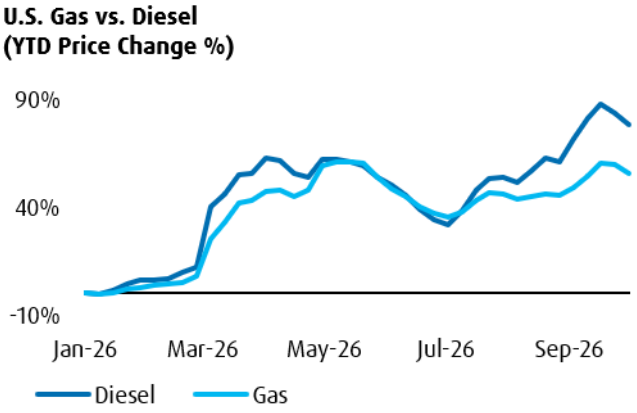
PMIs suggest economic momentum continues.



Source: Bloomberg L.P. (2026). PMI = Purchasing Manager Index. Data from Q1 2006 through Q2 2026.

Exhibit 3: Fuel divergence

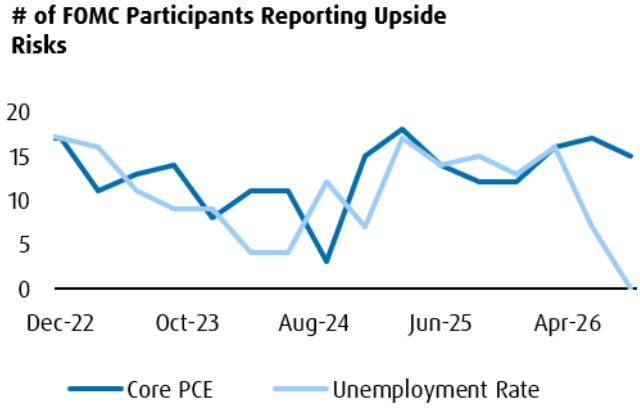
Diesel price gains have outpaced that of regular gas.



Source: Bloomberg L.P. (2026). YTD through October 5, 2026.

Exhibit 4: Purely price focused

Fed officials see risks only on the inflation side of their dual mandate.



Source: FOMC = Federal Open Market Committee (2026). Data from Q4 2022 through Q3 2026.

Market Review

Fixed Income

Continuing a common theme from 2026, interest rates moved higher again over the past month – leaving 10-year U.S. Treasury yields at their highest level in nearly 20 years. We believe this mostly reflects ongoing normalization from the post-GFC (Global Financial Crisis) era. Historically speaking, the 10-year yield has generally approximated nominal economic growth. Over the past few years, nominal growth has averaged ~5.7% – and is trending higher. By this standard, the current 5.24% 10-year U.S. Treasury yield is reasonable – if not low.

The yield backup is providing a more interesting entry point for investors – offering cushion against modest further rate increases before returns dip into the red and the potential for nice gains should rates noticeably decline (see Exhibit 5). We expect interest rates to remain volatile as they continue to normalize against the backdrop of an inflation-focused Fed. But we have recently reduced our tactical underweight to Investment Grade Fixed Income given the backup.

Credit Markets

Following nearly six months of relatively limited movement, both investment-grade and high-yield credit spreads started to widen in late September and into October. Both levels are still below 2026 highs, but the higher-rate backdrop has started to pressure the lowest-quality areas of the high yield market. Specifically, CCC-rated credit spreads have notably widened relative to higher-quality parts of the asset class this year (see Exhibit 6). For now, it appears to be a result one-off company issues – but it bears watching.

We recently further increased our tactical underweight to Credit Sensitive Fixed Income (e.g., High Yield), which has evened out our tactical underweights to interest-rate and credit risk (at 3% each). Over the course of 2026, we viewed higher interest rates as a bigger concern than higher credit spreads. But, with the recent interest-rate backup, we now see the two risks as fairly balanced – and prefer taking on all our tactical risk in the equity markets.

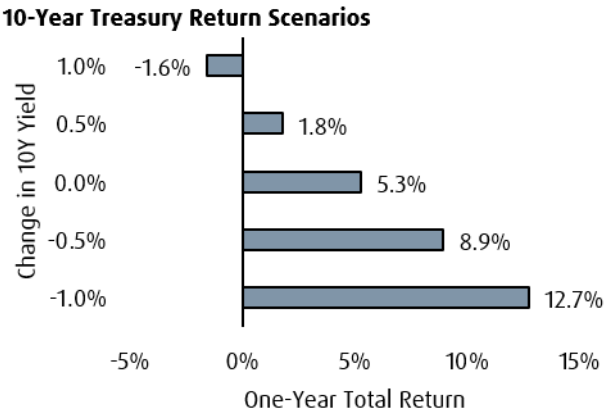
Equities

September delivered on its historical tendency for S&P 500 losses with a modest 0.4% decline for the month. As headwinds mounted from rising interest rates over the last six weeks, U.S. Large Cap fared best across global equity markets as the boost from tech-adjacent areas outweighed declines in most other sectors. Starting this week, investor attention will once again turn to earnings season – and investors may be harder to please this time around, with earnings-growth expectations at 30% coming into Q3 (see Exhibit 7).

Higher expectations suggest that the "easy money" may have already been made. But we still believe fundamental strength can lead to ongoing U.S. equity-market gains – both in Large Cap and Small/Mid Cap, (the latter benefitting from any reversal in interest rates). We are less constructive on International Developed – increasingly so, given the growing debt crisis in France (where government yields are above those of Italy and Greece) – where we retain a tactical underweight.

Exhibit 5: Yield advantage

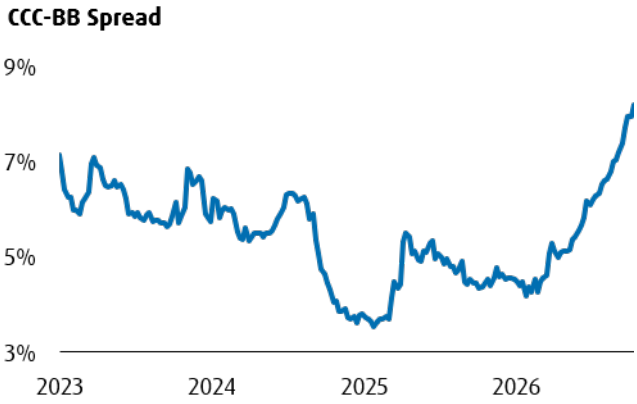
Yields would have to go 1% higher for a negative-return outcome.



Source: Bloomberg L.P. (2026). As of 10/1/2026.

Exhibit 6: Fault lines?

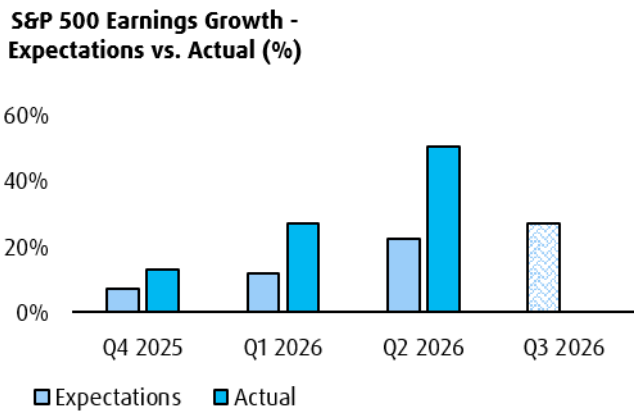
CCC spreads have moved higher – mostly idiosyncratic risks for now.



Source: Bloomberg L.P. (2026). As of 10/9/2026.

Exhibit 7: Harder to please

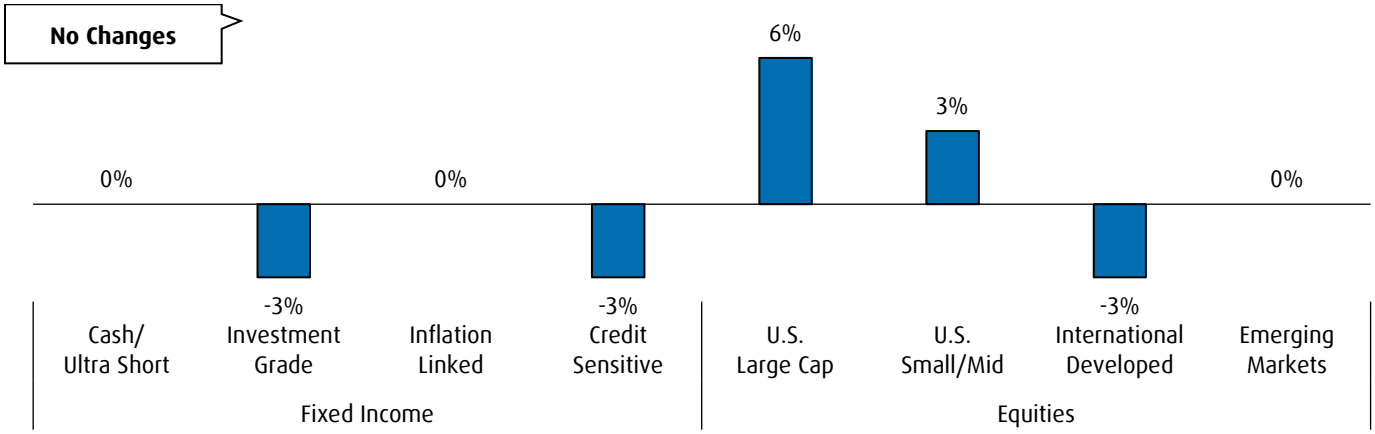
Recent earnings strength has only raised expectations higher.



Source: Bloomberg L.P. (2026). As of 10/9/2026.

Exhibit 8: Staying the course

Strong fundamentals support maintaining current tactical allocations – with a focus on U.S. Equities.



Tactical positioning represents BWM Investment Strategy Group policy-level recommendations as of 10/13/2026 and are subject to individual client situations.

Index Definitions

Cash: Bloomberg US Treasury Bill: 1-3 Months Index tracks the market for treasury bills with 1 to 2.9999 months to maturity issued by the US government**. Investment Grade:** Bloomberg U.S. Aggregate Index measures the investment grade, fixed-rate taxable bond market. **IG Credit:** The Bloomberg US Credit Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. **Muni:** Bloomberg 1-10 Year Blend Municipal Bond Index covers the short and intermediate components of the Bloomberg Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market. **Treasury: Bloomberg U.S. Treasury Index** measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. **Inflation Linked:** Bloomberg US Treasury Inflation-Linked Bond Index measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. **Credit Sensitive:** Bloomberg U.S. Corporate High Yield Index measures high yield, fixed-rate corporate bond markets. **High Yield Muni**: Bloomberg Muni High Yield Index measures the returns of high yield, fixed rate municipal bond markets. **U.S. Large Cap**: S&P 500® Index is an unmanaged index of large-cap common stocks. **US Small/Mid Cap:** Russell 2500 Index tracks the performance of approximately 2,500 small to mid-cap companies in the U.S. equity market. **Intl. Dev.:** MSCI EAFE Index Europe, Australasia, and Far East Index (EAFE) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. **Emerging Markets:** MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets in Europe, Latin America, Africa, Middle East and Asia. **Market data provided above is from Bloomberg L.P. unless separately stated and is as of 10/13/2026 unless separately noted.**

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