VIEWPOINT

THIRD QUARTER 2025

BONDING THROUGH TURBULENCE

BY THE NUMBERS

8.1%

The S&P 500 increased 8.1% in Q3 2025. This compares to an increase of 10.9% in Q2 2025, a decrease of -4.3% in Q1 2025, and 25.0% in 2024.

4.8%

International Developed markets increased 4.8% in Q3 2025. This compares to an increase of 11.8% in Q2 2025, an increase of 6.9% in Q1 2025, and an increase of 3.8% in 2024.

3.60%

Yield on the two-year Treasury was 3.60% on September 30, 2025. This compares to 3.72% on June 30, 2025, 3.89% on March 31, 2025, and 4.25% on December 31, 2024.

4.16%

The 10-year Treasury yield was 4.16% on September 30, 2025. This compares to 4.24% on June 30, 2025, 4.23% on March 31, 2025, and 4.58% on December 31, 2024.

22.9x

Price/Earnings ratio of the S&P 500 Index was 22.9x as of September 30, 2025. This compares to its 20-year average of 16.4x and 21.6x at the end of 2024.

15.2x

Price/Earnings ratio of the MSCI EAFE Index was 15.2x as of September 30, 2025. This compares to its 20-year average of 13.5x and 13.7x at the end of 2024.

"Bond selection is primarily a negative art. It is a process of exclusion and rejection, rather than of search and acceptance."

Benjamin Graham, the father of value investing

""It takes only a small fluctuation in the credit cycle to produce big consequences."

Howard Marks, co-founder of Oaktree Capital

Recent bankruptcies like First Brands[1] and Tricolor[2] remind investors that credit cycles are alive and well, even in an economy that still looks resilient on the surface. Our approach to fixed income remains disciplined and intentional. We view bonds not as a source of excitement, but as the steady ballast of the portfolio, anchoring capital through volatility while selectively capturing attractive yields where the risk-reward is justified. In this newsletter, we discuss how we structure our fixed income allocation and the managers we've chosen to help carry out that discipline.

As always, we start with our Market Summary, but if you'd prefer to jump into the portfolio discussion, please turn to page 3.

MARKET SUMMARY

The dominant theme in the third quarter was the rise of technology and productivity-driven optimism, led especially by the surge around artificial intelligence (AI) and its integration into corporate strategies. Equity markets saw strong gains (for example, the S&P 500 returned approximately 8.1 % in Q3) as investors responded to resilient corporate earnings, hopes for interest-rate cuts, and a broader shift toward efficiencyenhancing investment. While the economy showed mixed signals, the market's focus was increasingly on longer-term structural themes (AI, automation, infrastructure investment) rather than just near-term macro shocks.

While the economy appears steady, cracks are emerging in the labor market. Unemployment has risen to 4.3%, and recent jobs reports show sharp downward revisions, with non-farm payroll growth slowing month after month. These signs of weakness supported the FOMC's (Federal Open Market Committee or "the Fed") decision to cut rates in September.

The Fed cut rates by 25 basis points in September, lowering the target range to 4.00–4.25% after nearly a year-long pause. While such pauses are uncommon, history shows they are not unprecedented, with similar or longer gaps seen in the 1980s, 1990s, and early 2000s. The Fed's tone has turned more dovish as labor market conditions soften, even as inflation remains stubbornly above its 2% target.

U.S. equities delivered strong gains in the third quarter, supported by easier monetary policy and tariff rates that settled below initial peaks. Small caps stole the spotlight in the third quarter, beating large caps by more than 4% as measured by the Russell 2000 versus the S&P 500. Investors expected these companies to gain more from falling interest rates, given their higher leverage compared to larger peers. Optimism about stronger earnings growth in 2026 added fuel to the rally, reinforcing their edge during the quarter.

	2025		2024
Index	Q3 2025	YTD	
S&P 500	8.1%	14.8%	25.0%
Russell 2000	12.4%	10.4%	11.5%
MSCI EAFE	4.8%	25.1%	3.8%
MSCI EM	10.6%	27.5%	7.5%
Bloomberg U.S. Agg	2.0%	6.1%	1.3%
Bloomberg U.S. Govt 1-3 Yr	1.2%	4.1%	4.4%
Bloomberg U.S. Corp Hyld	2.5%	7.2%	8.2%
FTSE NAREIT Equity REITs	2.7%	4.5%	4.9%
Bloomberg Commodity Index	3.6%	9.4%	5.4%

Source: Morningstar Direct, FactSet; Data as of 09/30/2025 [3]

International markets finished higher overall, though performance varied across regions. Emerging markets stood out with double-digit returns, driven in part by China's surge of more than 20%, supported by easing trade tensions and robust AI-related growth.

Interest rates declined in the third quarter as the FOMC cut its target rate by 25 basis points, the first reduction since December 2024. This move boosted core bond returns in a more favorable rate environment.

High yield bonds held firm despite stretched valuations, supported by strong demand for income, solid corporate fundamentals, and expectations of further monetary easing that tightened credit spreads.

U.S. equity REITs benefited from falling interest rates in the quarter, delivering modest gains overall. Health care led performance as defensive sectors outpaced the broader market, while retail posted strong returns thanks to resilient consumer spending despite labor market shifts.

Commodity markets delivered mid-single-digit gains for the quarter, powered by a sharp rally in precious metals, led by gold hitting new highs. The surge was fueled by the Fed's rate cut, persistent inflation, and heightened concerns over a potential government shutdown.

Bonding Through Turbulence: Steady Amid the Storm

Recent bankruptcies like First Brands and Tricolor offer a timely reminder that credit risk never disappears; it only hides when liquidity is abundant. These failures weren't caused by one single macro shock, but the companies struggled under too much debt in a world where interest rates have stayed higher for longer. For disciplined fixed income investors, they reinforce why credit research, diversification, and structure matter far more than chasing yield.

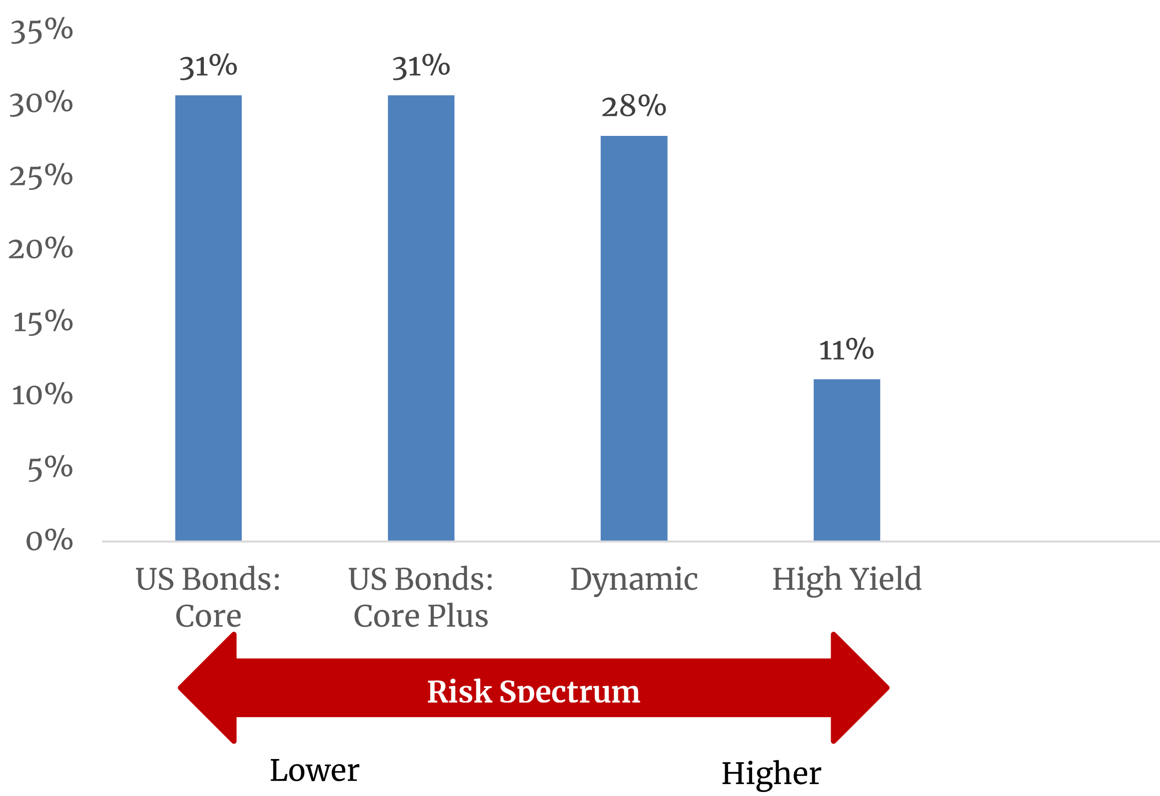
At Lee Financial, we continue to view fixed income as the steady anchor of a portfolio. It's not meant to be exciting; it's meant to be reliable. Our bond holdings are intentionally selected to preserve liquidity, reduce volatility, and provide dependable income, while selectively adding higher-yield opportunities where we believe the extra risk is worth taking.

This quarter's news cycle reinforces that lesson. Credit spreads have remained relatively tight, but selective stress beneath the surface hints at the later stages of a credit cycle. Our approach remains patient and balanced: maintain quality, respect the math of compounding, and let bonds do what they're meant to do: keep portfolios steady amid the storm, so we're ready when the clouds clear.

Putting this philosophy into practice begins with our asset allocation mix and the managers we partner with.

Fixed Income Asset Allocation

Below is a representation of our current asset allocation mix and where the bond strategies sit on the risk spectrum.[4]



Source: Lee Financial. The asset allocation mix is based on Lee Financials' 100% bond or stable value allocation less the divergent position. The illustration is for educational purposes only. Past performance is no indication of future results.

Below we outline the key building blocks of our bond allocation and how each component contributes to the portfolio's stability and return potential.

Core & Core Plus

- The anchor to the bond portfolio.

Dynamic Bond

- A more flexible mandate that adds additional diversification and potentially higher yields.
- It introduces into our bond portfolio:
    - Non-U.S. bonds.
    - Scaling of risks taken – duration and credit.

High Yield

- It adds yield.
- It adds diversification to traditional fixed income.
- It adds diversification to the equity portfolio.

Core Bond and Core Plus

These are our two stabilizing investments in our portfolio with some overlapping features. Core Bond funds offer a diversified portfolio of high-quality bonds. Typical investments inside the fund include U.S. Treasuries, government agency, mortgage-backed, and invest-grade corporate bonds. These funds are designed to provide steady income and stability. Again, it serves as the foundation or "core" of our portfolio by helping to preserve capital and cushion against stock market volatility while still earning a modest return from interest payments.[5]

Core Plus funds start with the same high-quality U.S. bonds foundation as core bond funds, but it adds a little extra "kick" or "plus". This "kick" comes from some exposure to high yield bonds, global bonds, and/or emerging market bonds. So, it is used to enhance income and long-term growth potential while still playing a stabilizing role in a diversified portfolio, though with a bit more risk than a pure core bond fund.[6]

Dynamic Bonds

With our anchor in place, we looked to add further diversification and potential yield. That's where Dynamic Bond funds come in as it gives experienced managers the flexibility to adjust what types of bonds they hold and how much interest rate or credit risk they take as market conditions change. In other words, it lets us lean in when opportunities arise and dial back when risks increase, helping keep the portfolio both steady and productive over time.[7]

High Yield

Next, we looked to add additional yield to our fixed income portfolio and to add diversification across both our bond and equity allocations. This led us to a High Yield bond fund, which invests in bonds from companies with lower credit ratings that pay higher interest to compensate for greater risk. This allocation helps enhance income and total return, while remaining a smaller, complementary position given its higher volatility and credit sensitivity.[8]

You may recall from our Q4 2025 LFC Viewpoint that we made several changes to our 2025 asset allocation, including reducing part of our Core Bond and Core Plus positions to increase our Dynamic Bond position. We also highlighted various key themes influencing our thinking, including sticky inflation and increased market volatility. Given the themes, we wanted to take a more conservative stance on interest rate risk through our portfolio's duration positioning.

As a reminder, duration measures how sensitive a bond's price changes with changes in interest rates. If a bond has a duration of 6 years, would typically lose about 6% in value if interest rates rise by 1% and gain about 6% if interest rates fall by 1%.

Both our Core Bond and Core Plus managers maintain durations closely aligned with the bond benchmark, avoiding large directional bets on interest rates.[9] By contrast, our Dynamic Bond manager has the flexibility to adjust exposures across sectors and maturities. The manager has very tight risk controls and has historically shown an ability to capture upside potential and yield without excessive risk.[10] Importantly, the portfolio typically has a shorter duration than the overall bond index.

When combined, our bond allocations produce an overall portfolio duration of roughly five years, compared to about six years for the benchmark.[11] We believe this positioning helps balance risk and reward, providing more potential upside if rates stabilize or decline, while offering less downside exposure if rates rise further.

The table below illustrates this dynamic by highlighting 5-year maturities for both U.S. Treasuries and U.S. Investment Grade (IG) bonds, which approximate our portfolio's duration. It shows how total return changes under 1% and 2% interest rate shifts.

Bond Sensitivity Analysis to Rate Changes

		Total Return from 1 % yield		Total Return from 2% yield	
Bond Type	**Yield**	**Sell-off**	**Rally**	**Sell-off**	**Rally**
UST 2 yr	3.48%	1.56%	5.39%	-0.35%	7.30%
UST 3 yr	3.48%	0.67%	6.29%	-2.14%	9.11%
UST 5 yr	3.60%	-0.92%	8.11%	-5.42%	12.65%
UST 7 yr	3.78%	-4.11%	9.85%	-8.35%	15.92%
UST 10 yr	3.99%	-11.49%	12.11%	-12.21%	20.23%
UST 30 yr	4.58%	-7.59%	20.70%	-27.53%	36.84%
US IG 3 yr	4.25%	2.87%	5.64%	1.45%	7.02%
US IG 5 yr	4.35%	2.12%	6.57%	-0.10%	8.79%
US IG 7 yr	4.56%	1.52%	7.60%	-1.52%	10.65%
US IG 10 yr	4.44%	0.32%	8.56%	-3.79%	12.69%

Source: FactSet. Lee Financial calculations as of 10/2025.Total return calculated by adding changes in price due to treasury move in a one-year period using duration and convexity as published in FactSet. Past performance is no indication of future results.

As seen above, if interest rates rise by 1%, a 5-year U.S. Treasury would decline 0.92%, while a 1% drop in rates would result in a gain of 8.11%. The same asymmetric pattern is visible in the U.S. IG 5 yr demonstrating how moderate duration positioning can limit downside risk while preserving meaningful upside potential.

Together, these layers of fixed income, core stability, selective flexibility, and targeted yield, form a balanced structure designed to preserve capital, generate income, and adapt through changing markets.[10]

The Managers Who Anchor the Portfolio

With our fixed income framework in place, the next step is choosing managers who can bring it to life with discipline and consistency. Each plays a distinct role, providing stability, flexibility, or yield, but all share a common foundation: a well-constructed, repeatable investment process and clear alignment of incentives. We look for teams that not only manage risk thoughtfully but also have an edge, whether through unique insights, experience, or structure, that supports long-term results for our clients.

Core Bond

We selected our core bond manager because it offers a straightforward, repeatable strategy and a disciplined, team-based process. The fund has a strong record of consistent performance, competitive costs, and a focus on high-quality, diversified bonds. [10, 12] We believe its simplicity, stability, and alignment between fund management and client outcomes make it a reliable anchor within our fixed income allocation.

Core Plus

We chose our core plus bond manager for its disciplined, research-driven process and long-standing commitment to value investing. The fund is managed by an experienced, stable team whose ownership structure and incentives are closely aligned with client outcomes. This combination of process, experience, and alignment has helped the fund show consistent performance vs its benchmark and peers over multiple periods.[10, 12]

Dynamic Bonds

Our dynamic bond manager was selected for its comprehensive, risk-aware, and repeatable investment process. The fund combines top-down macro insights with bottom-up research and leverages the firm's extensive global resources, data analytics, and risk management tools. Led by a veteran investor, the strategy has delivered consistent, top-half performance through disciplined positioning and active risk control. [10, 12]

High Yield

We selected our high-yield bond manager for its unique, research driven process and disciplined focus on risk management. Led by a highly experienced portfolio manager, the team emphasizes strong business models with quality cash flows, and downside protection rather than simply reaching for yield. Their independent, well-aligned structure and repeatable approach have produced consistent, top quartile results over multiple long-term periods. [10, 12]

WRAPPING UP & PORTFOLIO CHANGES

We remain confident in all our recommended portfolio managers, both on the equity, real asset and fixed income side of our portfolio. All our recent equity and fixed income changes are fully reflected in our portfolio. Our real asset (real estate, infrastructure, or energy) changes continue and are almost complete.

Through our focus on diversification, we believe we are well positioned to ride out any short-term volatility. Our goal is to provide our clients with peace of mind by building portfolios that are resilient to various market conditions. We are also laser focused on a long-term investment perspective to best capture the effects of compounding returns.

In all our portfolio moves, we remain focused on tax efficiency. As we have often said, it is what you keep at the end of the day that matters. Please contact a member of your Lee Financial team if you have any questions.

Marco Rodriguez, CFA
Co-Chief Investment Officer, Director of Research

1 First Brands Group is a U.S. aftermarket auto-parts-supplier that filed Ch 11 in September 2025*. According to various new sources, the company racked up over $11 billion in liabilities and used opaque off-balance sheet financing and invoice factoring practices.*
[2] Tricolor was the third-largest used car retailer in Texas and California. It also provided subprime auto loans. It filed for Ch 7 in September 2025 after alleged fraud and double-pledged loan collateral surfaced. According to various new sources, the collapse left more than 25,000 creditors and between $1 billion and $10 billion in liabilities.
[3] The S&P 500 is a stock market index that tracks approximately 500 of the largest publicly traded companies in the U.S. based on market capitalization The Russell 2000 index is a stock market index that tracks the performance of 2,000 small-cap U.S. companies. The MSCI EAFE Index is a stock market index that measures the equity performance of large- and mid-cap companies in 21 developed market countries, excluding the US and Canada. The MSCI Emerging Markets Index is a stock market index that tracks the performance of large and mid-cap companies in 27 emerging market countries. The Bloomberg US Aggregate Bond Index is a broad measure of the U.S. investment-grade bond market that includes U.S. government and corporate bonds, mortgage-backed securities, and asset-backed securities. The Bloomberg US Government 1-3 Year Index tracks the performance of U.S. government bonds with maturities between one and three years. The Bloomberg US Corporate High Yield Index is a market-value-weighted index that tracks the performance of fixed-rate, taxable, USD-denominated corporate bonds with non-investment-grade ratings. The FTSE Nareit index series are benchmark indices that track the performance of publicly traded real estate companies, or REITs. The Bloomberg Commodity Index (BCOM) is a diversified index that tracks the performance of futures contracts on physical commodities, representing 22 different commodities across six sectors
[4] Risk spectrum is defined as volatility or standard deviation.
[5] Core bond funds primarily invest in high-quality government, agency, and investment-grade corporate bonds. These funds are subject to interest rate and credit risk, and the value of their holdings will generally decline as interest rates rise. Although designed to provide stability and income, core bond funds are not guaranteed and may lose value.
[6] Core plus bond funds include traditional core holdings but may also invest in higher-yielding or non-U.S. bonds to enhance return potential. These additional exposures introduce greater credit, liquidity, and foreign investment risk. While the strategy can offer higher income, it may also experience more volatility than a traditional core bond fund.
[7] Dynamic bond funds have greater flexibility to shift among sectors, durations, and credit qualities in response to market conditions. This flexibility can enhance returns but also increases the potential for volatility and loss if market views or timing prove incorrect. Active management and diversification do not guarantee positive results or protect against market declines.
[8] High-yield bond funds invest in lower-rated securities that offer higher income but carry greater credit and default risk. These funds may experience larger price swings and reduced liquidity, particularly during periods of market stress. While they can enhance overall portfolio income, they should be viewed as a higher-risk complement to investment-grade bond holdings rather than a core allocation.
[9] Bloomberg U.S. Aggregate Index tracks the performance of a wide range of U.S. investment grade bonds, including government, corporate, and mortgage-backed bonds. It's often used as a benchmark for the overall bond market.
[10] All investments involve risk, including loss of principal. Fixed income securities are subject to interest rate, credit, and inflation risk, and their value generally declines as interest rates rise. Diversification across strategies—such as core, core plus, dynamic, and high-yield bonds—does not ensure a profit or guarantee against loss. Each strategy carries distinct risk and return characteristics, and portfolio results will vary based on market conditions, manager decisions, and the mix of holdings. Past performance is not indicative of future results.
[11] Aggregate duration is equal to the sum of Lee Financials weighted positions in each bond fund. The index comparison is the Bloomberg U.S. Aggregate Index. Duration figures from FactSet and calculations are as of 10/27/2025.
[12] Performance returns and ranking from Morningstar Direct as of 9/30/2025. Past performance is no indication of future results.

DISCLOSURES

Please remember that past performance is not indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by LFC), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from LFC. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. LFC is neither a law firm, tax expert, nor a certified public accounting firm and no portion of the newsletter content should be construed as legal, tax, or accounting advice. A copy of the LFC's current written disclosure statement discussing our advisory services and fees is available upon request. If you are an LFC client, please remember to contact LFC, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services.

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