Market Recap

Investors are navigating a demanding environment, where forces are pulling in opposite directions. Equity markets sit near record levels supported by corporate earnings and consumer spending, while key economic indicators suggest the economy is slowing. The Federal Reserve's September decision to restart rate cuts adds a supportive backdrop for equity markets, while elevated valuations serve as a reminder that risks remain, particularly if economic and corporate earnings growth slows more than expected. Some major policy uncertainties such as disruptions from tariffs appear largely behind us (for now), but with midterm elections around the corner, debates over fiscal and monetary policies will likely intensify, testing investors' discipline and conviction. Our current view is that the positives have the upper hand, providing a cautiously constructive backdrop. By grounding our approach in data, applying historical context, and challenging our assumptions, we strive to guide portfolios through market uncertainties, while remaining attentive to evolving risks.

Altrius' Performance

Each of Altrius' strategies has experienced strong absolute performance for the year. Our flagship balanced Global Income strategy, which is comprised of our U.S., international and fixed income strategies, posted gross returns of 15.4% year-to-date. Our Disciplined Alpha Dividend strategy (U.S. all-cap stocks) was higher by 10.8%, while our International ADR Dividend Income strategy (international stocks) grew by 27.8%. Our Unconstrained Fixed Income strategy (primarily U.S. high yield bonds) rose 6.6% for the year. All of the returns are shown with gross results from January 1 through quarter-end September 30, 2025.

Investment Outlook and Portfolio Positioning

Markets are always reacting to news, but today it feels even more pronounced. Every data release, policy comment, or geopolitical headline seems to carry an outsized influence on investor sentiment. This heightened sensitivity seems justified, as investors try to determine the path forward. Will the economy continue to slow under the weight of tighter financial conditions, or can momentum continue?

Against this noisy backdrop, there are reasons for optimism. One important tailwind comes from monetary policy. The Federal Reserve's recent rate cut, after a prolonged pause, provides a constructive backdrop for both equities and bonds. Lower rates reduce borrowing costs for consumers and corporations, potentially fueling further investment and spending. History also offers perspective. A study by J.P. Morgan found that when the Fed cuts rates with the S&P 500 within 1% of an all-time high, the index has averaged a 15% gain over the following 12 months.

The consumer also remains a source of strength. The U.S. economy is primarily driven by consumption, often described as the backbone of growth. Spending has held up well across much of the economy, even after adjusting for inflation. While income and spending levels are not distributed equally (i.e. there are meaningful disparities across households), overall consumption has been supported by real wage growth that has outpaced inflation in many segments. This has enabled households to absorb higher costs without meaningfully pulling back. Balance sheets, meanwhile, remain generally healthy, the result of higher brokerage accounts and stable housing values. Despite higher mortgage rates, housing continues to serve as a source of household wealth and an important piece of consumer confidence.

Corporate fundamentals add another layer of support. Earnings growth rose 11.7% in the second quarter, making it the third consecutive quarter of double-digit growth. Many companies reported expanding margins, improved efficiency, and positive forward guidance. These results provide a foundation for higher equity valuations.

Importantly, market leadership has begun to broaden. While much attention has been focused on a handful of large-cap technology companies, gains have recently extended across a wider set of sectors. This improved breadth suggests a healthier rally, less reliant on a narrow cohort of stocks.

Of course, risks remain. We are closely monitoring the labor market. Key indicators such as quit rates, layoff rates, and initial unemployment claims have all flatlined. We seem to be at stall speed, and conditions could shift either way, so we're monitoring developments closely, especially the unemployment rate.

Since April, job gains averaged around 53,000 per month, which aligns closely with estimates of breakeven job levels needed to keep unemployment steady. We are not yet seeing broad-based layoffs or the kind of deterioration that typically signals an outright downturn.

Deciphering the job market data is not as easy as reading the headlines. In recent years, immigration has led to large swings in labor supply and distorted the relationship between payroll growth and unemployment. When labor supply expanded quickly in 2023 and 2024, job gains looked strong but were outpaced by labor force growth, leading to higher unemployment. Conversely, when supply growth slowed in late 2024 and early 2025, job growth weakened but the unemployment rate held steady. More recently, employment growth has slowed further, yet the number of job seekers remains roughly in line with available jobs. The key point is that payroll growth can look strong when conditions are deteriorating and appear weak when the market is relatively balanced. Today's combination of modest job growth and a stable unemployment rate suggest the labor market is slowing but not collapsing. We continue to watch the data closely for signs of further weakening.

In short, while near-term uncertainty can test long-term conviction, we believe this environment highlights the importance of discipline. Staying focused on fundamentals and resisting the temptation to be swayed by short-term noise remains the most effective approach to navigating markets.

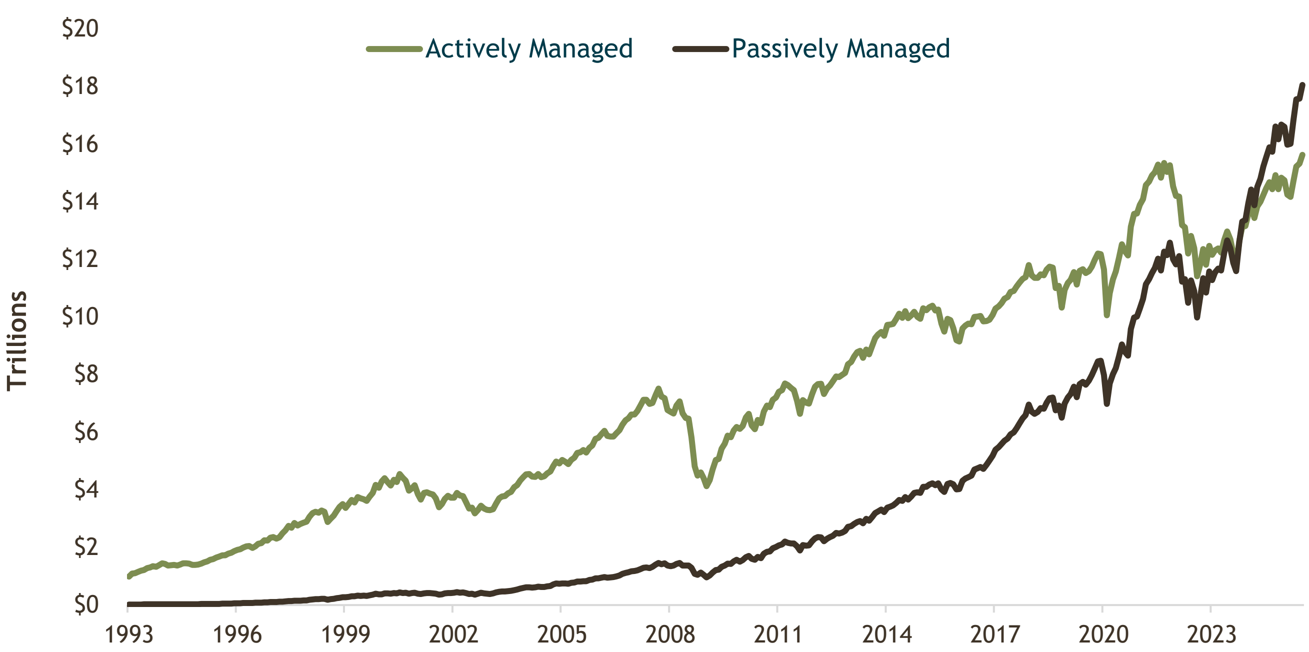
Equities

At the beginning of the year, consensus return expectations for U.S. equities were in line with the historical average of about 8%. Year to date, U.S. stocks have exceeded those assumptions reaching an all-time high, driven by corporate earnings growth, persistent enthusiasm around AI and technology, and an improving macroeconomic backdrop.

Naturally, current price levels raise the question of valuation. Today, the S&P 500 trades at roughly 26x trailing 12-month earnings compared to a long-term average of 16-17x. In contrast, our current portfolio of companies is selling at a very reasonable 12 1/2 times earnings in contrast to the sky-high valuations of the large tech companies. We have owned some of these companies over the past years (Apple, Microsoft, Broadcom and Qualcomm); however, we sold them in recent years due to valuation after significant gains and diminished dividends.

The rise of passive investing has fundamentally altered flows into equities. With defined contribution plans replacing defined benefit pensions, most workers invest steadily into markets regardless of valuations. Morningstar data shows that as of late 2023, passive assets overtook active assets for the first time. These consistent inflows, which are often valuation-agnostic, provide some support for higher multiples.

Passive Assets Eclipsed Active Assets at the End of 2023

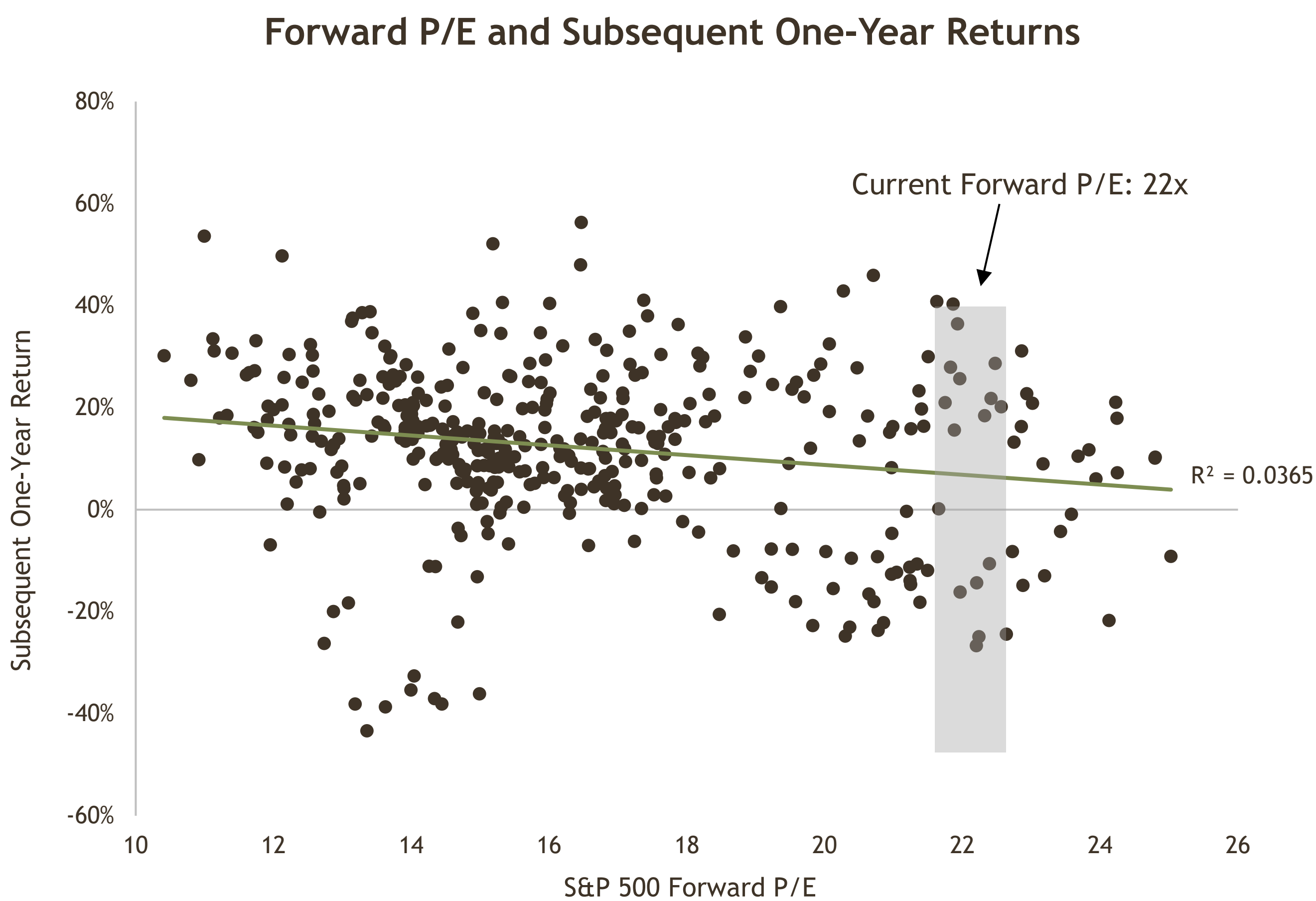


Source: Morningstar Direct. Data as of 8/31/2025.

At the same time, equity supply has been shrinking. The number of publicly listed U.S. companies has fallen by about half since 1996, and corporations have been consistently repurchasing shares. In fact, preliminary estimates put S&P 500 buybacks in the second quarter of 2025 at $235 billion, bringing the trailing 12-month total to roughly $1 trillion. This reduction in supply, combined with steady demand, has been another force sustaining higher valuations.

Exuberance can push valuations beyond reason. Excessive risk-taking and investor optimism will always have the potential to drive markets to extremes. Under certain stress scenarios such as recessions, financial shocks, or sharp policy missteps, multiples can and may fall well below current levels.

Today, valuations are at about 22x forward earnings, which is high relative to history. When we look at past periods (shown in the gray shaded bar in the chart below), subsequent 12-month returns following similar valuation levels have been extremely wide, ranging from significant losses to strong gains. This wide dispersion highlights that while valuations can inform long-term expected returns, they are a poor tool for short-term market timing. Other factors such as earnings growth, monetary policy, and investor sentiment tend to play a much larger role in driving market performance over a one-year horizon.



Source: Bloomberg LP. Data as of 9/25/2025.

Fixed Income

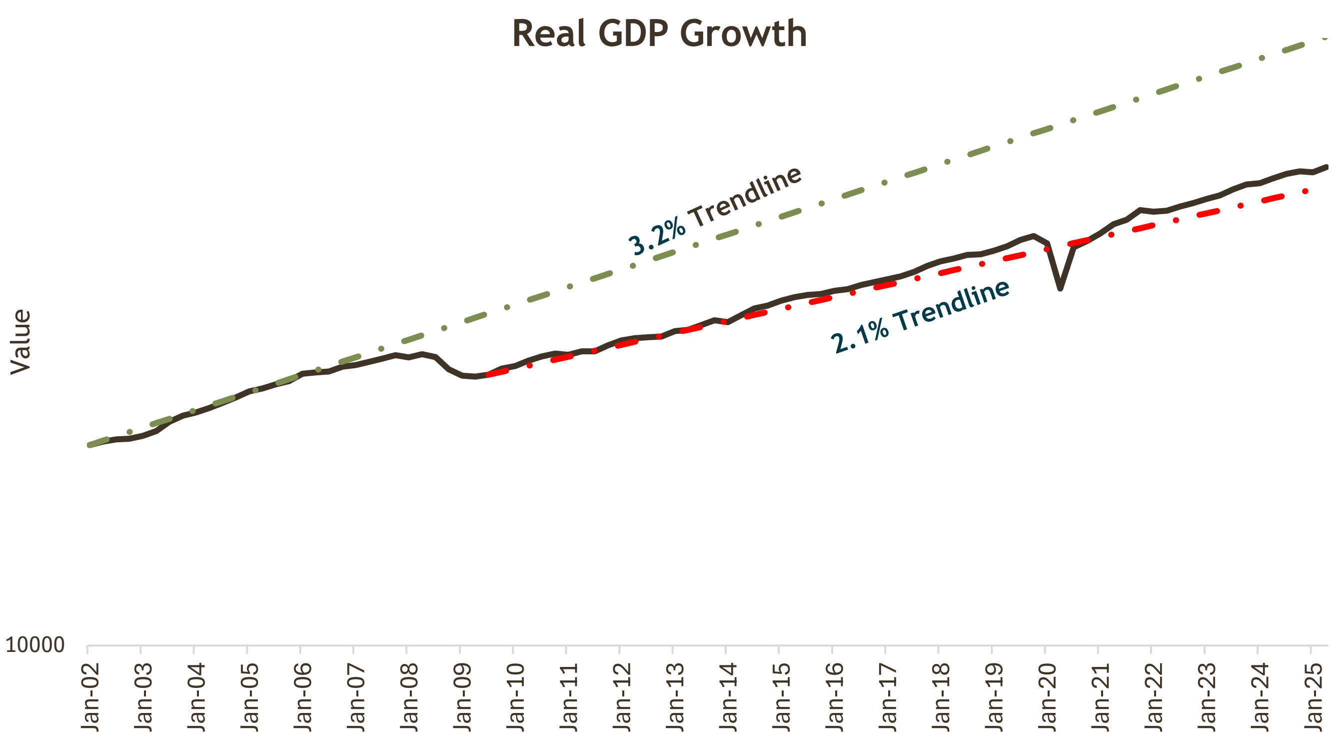
The U.S. fixed income market saw the Federal Reserve re-initiate rate cuts in late September, lowering the federal funds target range by 0.25% to 4.00%–4.25%. This was the first cut this year, but not the first of this cycle. The Fed previously eased three times from September to December 2024, totaling 100 basis points of cuts, but paused over concerns that inflation remained stubbornly elevated above their 2% target and that policy might be loosening too quickly.

The Fed's recent decision to cut was positioned by Fed Chair Powell as a "risk-management" step given concerns over softening labor market data and slowing economic growth. Looking ahead, the Fed is leaving the door open for additional cuts, but Powell has been careful to emphasize that further easing will be data dependent with the goal of balancing the risk of higher inflation with supporting growth.

Notably, there is increasing divergence among Fed governors about the appropriate pace of easing. Some, like newly appointed Governor Miran, have aligned more closely with the government's push for aggressive rate reductions, advocating for much lower rates, suggesting that the Fed Funds rate should be two percentage points lower. Other Fed members have signaled a preference for a more measured approach, warning that cutting too quickly could undermine progress on inflation and introduce instability. This debate underscores the uncertainty around the policy path and suggests that Fed perspectives could vary in the months ahead.

One metric used to assess how accommodative or restrictive Fed policy is, is the real (inflation-adjusted) fed funds rate. Today, the real fed funds rate stands at roughly 1.2%. In prior cycles, levels of 3.5% or higher have historically proven too restrictive, ultimately choking off growth and leading to recession as the Fed waits too long to ease.

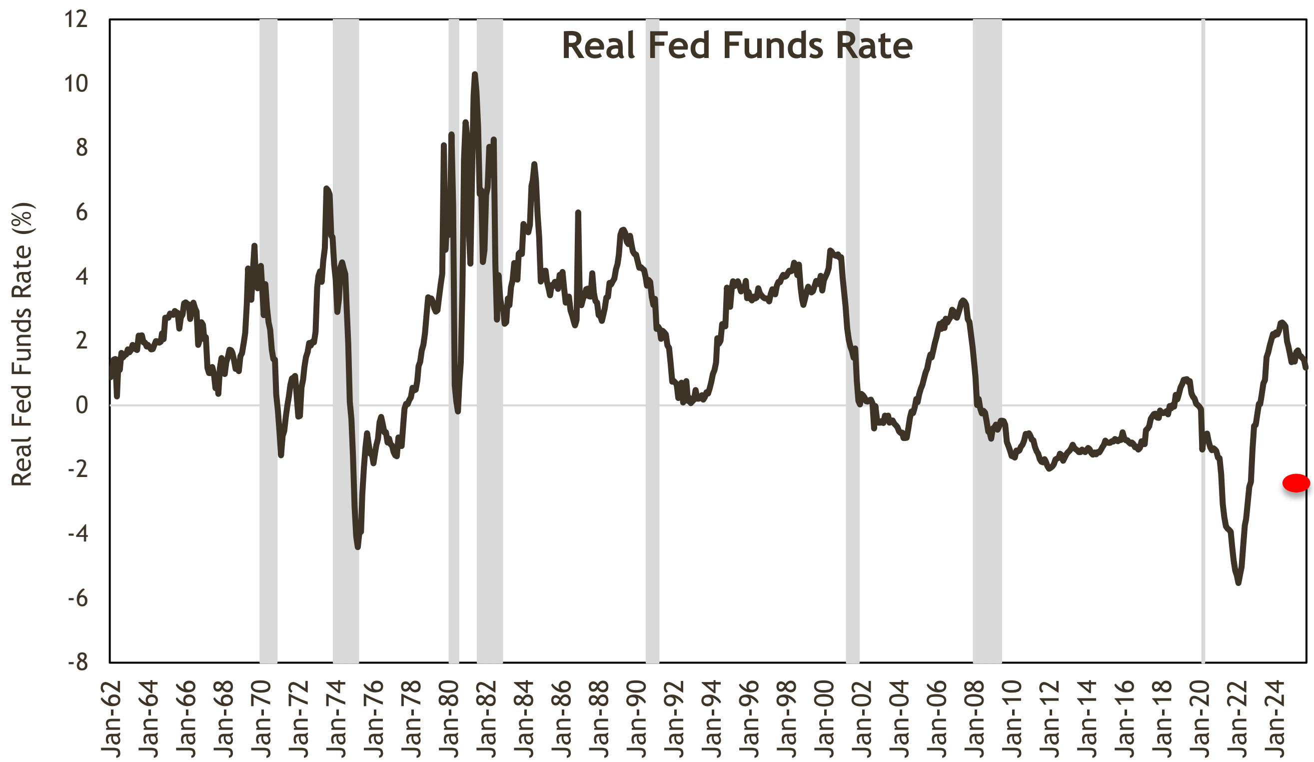
Today, we think the level of real fed funds rate needed to cool an overheated economy is lower than past cycles. The reasons lie in a slower-growing economy. As shown in the chart on the next page, economic growth has slowed from an average of 3.2% between 1965 to 2008 to 2.1% since the 2008 financial crisis. The reasons for the slower growth are broad and multifaceted, and include demographics and shrinking labor force participation, increasing federal transfer payments, etc.



Source: FRED, As of September 2025

With trend growth now closer to 2.0%, the economy is less able to absorb high real rates without stalling. At the same time, the neutral R-star (r*), the rate that is neither too loose nor too tight is closer to 0.5%–1.0% in real terms. That means a 1.2% real rate, while modest in absolute terms, sits above neutral today and therefore applies more restraint than the same level would have in prior decades.

Against this backdrop, recent comments from new Fed governor Miran suggesting that rates should be two full percentage points lower appear disconnected from current conditions. (See the red dot in the chart below.) Such a stance would only be warranted if the economy were already in recession. Instead, we've just posted GDP growth north of 3% and a labor market that, while slowing, remains stable. In our view, today's rate levels reflect a cautious but appropriate stance rather than a policy error in need of immediate and meaningful correction.



Source: FRED, As of September 2025

Futures markets, meanwhile, are pricing in more aggressive cuts, with expectations for four to five additional moves (to around 2.75%) through 2026. This divergence highlights the risk that if inflation remains sticky, the Fed may disappoint markets by cutting less than anticipated. Furthermore, there is the possibility of the bond market reacting counterintuitively to further easing. We saw evidence of this after the September cut when short-term yields declined modestly, but longer maturities edged higher, leading to a steepening of the yield curve. Rising long-term yields likely reflect a mix of persistent inflation concerns, elevated fiscal deficits, and an increased term premium.

Credit markets remain resilient, with investment-grade and high-yield spreads tightening further toward cycle lows, underscoring strong fundamentals and persistent demand for yield. Over the past several years, many corporations have de-levered, extended maturities, and improved balance sheet quality, leaving them in a stronger position to withstand higher rates and slower growth. By contrast, the federal government has moved in the opposite direction, taking on significantly more debt and sustaining elevated levels of spending. This divergence highlights that corporate credit risk is not the same as sovereign credit dynamics, and investors appear comfortable distinguishing between the two. While spreads may have limited room to tighten further, current levels reflect both healthy corporate fundamentals and demand for yield.

Looking ahead, a number of scenarios could unfold. Our current base case is for the economy to continue grinding ahead, avoiding recession with slower but positive growth, while inflation remains rangebound. In this outcome, the curve will steepen modestly as short-term rates drift slightly lower as the Fed eases, while long-term yields remain anchored by moderate growth expectations. This would be supportive for risk assets with credit spreads remaining tight, and equity valuations holding up.

A second potential outcome is a reacceleration with stronger growth and sticky inflation. We would expect the Fed to slow or halt easing, and short-duration strategies could outperform. Long-term yields would rise as rising inflation risk is repriced. This outcome would put pressure on long-duration bonds, and depending on how high rates go, it could put pressure on equity valuations, particularly the high-valuation growth equities, while cyclicals and credit markets could benefit from stronger nominal growth.

In a recessionary environment with negative growth and fading inflation, we'd expect the Fed to cut aggressively, pushing short rates down sharply. Credit spreads would widen and equities would weaken.

Today's environment suggests maintaining flexibility, emphasizing credit selectivity, and closely monitoring economic data that will shape market expectations.

Closing Thoughts

We enter the final quarter of the year with both opportunity and uncertainty. Equities are supported by resilient earnings, healthy consumer demand, and a more accommodative Fed, yet valuations remain elevated, and policy debates loom large. In fixed income, tight spreads reflect strong corporate fundamentals even as fiscal pressures and policy divergence create risks at the long end of the curve. Labor markets are softening but not collapsing, reinforcing the view that growth is slowing rather than outright stalling.

This is a moment to stay disciplined. Near-term volatility and policy noise will likely continue, but fundamentals (i.e. healthy balance sheets, consumer spending, and improving breadth in equity markets) are providing a constructive backdrop. We continue to maintain diversified portfolios, balancing risk and opportunities, and positioning to benefit from long-term secular trends while staying alert to evolving macro and policy risks.

As always, we remain committed to helping you navigate this dynamic environment with a disciplined, long-term approach. We appreciate your continued trust.

Disclosures

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