

# ASB Investment Management

## Institutional Portfolio Management Quarterly Review

### EQUITY OVERVIEW

In the third quarter of 2025, US equity markets continued their steady climb to new record highs from their nadir in April of this year. The S&P 500 had a total return of 8.11% for the quarter and the index now has a total return of 14.81% for the year.

Recent economic data points have been decidedly mixed. There was enough apparent weakness in the labor market for the Federal Reserve to lower short-term rates by a quarter of a percentage point. However, it's not clear if this will become a trend or if the Fed is simply sticking a toe in the water before committing more fully to future rate cuts. The Fed is trying to make sense of a myriad of mixed economic signals from an apparent slowdown in employment, to a stronger than expected GDP reading, to sticky inflation. More than is usually the case, the Fed is going to have to react to events as they unfold with an extremely uncertain set of macroeconomic variables. Investors seem to be optimistic that the Fed will be a benign force for markets going forward. That assumption may be tested, especially if inflation fails to retreat toward the Fed's long-term target.

Economic growth in the US continues to be supported by the titanic amount of spending on the build-out of infrastructure to support what is touted to be a technological revolution driven by advances in artificial intelligence ("AI"). Firms related to AI continue to lead gains in the asset values of both public and private companies. The economic logic

of this spending boom has yet to become clear. For now it is based on sanguine assumptions about the future rather than strong supporting evidence that this investment will result in strong returns on capital.

### EQUITY OUTLOOK

Investors in equity markets participate in such investments with the hope of garnering outsized gains over time versus many other investment options. As is rightly acknowledged, and has been demonstrated historically, this comes with risk. Equities are volatile. They are subject to bouts of extreme investor optimism and pessimism, which translate directly into the volatility of market prices.

There are many approaches to equity investing, some of which amplify risk and volatility and some of which seek to mute it. We attempt to implement the latter strategy. At both the individual company and portfolio construction levels we try to be highly cognizant of downside risks.

As equity managers our goal will always be to grow client assets over time, but we think it matters how you get there. Two equity managers may have

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equivalent returns over a specific period, but one may experience significantly more volatility than the other. In other words, one may take more risk to get there. Both managers may get you from point A to point B with similar results, but what about points C and D and beyond? In sum, we think it is essential to keep the long term in mind rather than to try to drive short-term gains through excessive risk taking.

### FIXED INCOME OVERVIEW

For fixed income investors the third quarter was a Goldilocks market in an environment that was neither too hot nor too cold. Modest price appreciation drove single digit total returns that outperformed coupon income and yields. The Aggregate Bond index registered a 2% return for the quarter, and intermediate indexes with shorter maturities returned between 1.5% and 1.8%.

The Federal Reserve has two mandates: promoting maximum employment and stable prices. Different environments give significance to different measures of the economy. In the inflationary environment of the '70's investors anxiously anticipated weekly money supply figures announced on Thursday afternoons. Today, the most important monthly release is the Bureau of Labor Statistics' (BLS) payroll report announced at 8:30 a.m. on the first Friday of every month. This report offers more insight than any other regarding the economy's

health and the Fed's mandate to promote maximum employment with stable prices.

On the morning of Friday, August 1st, the BLS announced that non-farm payrolls increased a modest 73,000 in July, versus 147,000 in June. The July figure underwhelmed forecasters expecting 100,000 new jobs. Ten-year Treasury yields fell 20 basis points amidst the sign of a weaker than expected economy, and the need for lower interest rates to spur economic activity. In a move widely criticized by economists across the political spectrum, President Trump fired the head of the BLS hours after the release of the disappointing jobs report.

On September 5th, the BLS announced that August payrolls increased only 22,000, revised payrolls for the previous two months downward by 28,000 and reported an increase in the unemployment rate to 4.3%.

Four days later the BLS reported a revision to non-farm payrolls showing that 911,000 fewer jobs had been created than previously announced in the twelve-month period ending in March. This revision convinced any remaining doubters that the Fed would lower interest rates for the first time this year at its next FOMC meeting less than two weeks away.

On September 17th, the Fed announced a 25-basis point easing of the short-term discount rate to 4.25%. The move was the Fed's first reduction of

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interest rates since last November. Federal Reserve Chairman Powell cited downside risks to the labor market as the chief reason for the move.

## FIXED INCOME OUTLOOK

Investors across asset classes, not only of the fixed income variety, are aware that credit spreads are tight. The expensive level of valuations holds whether evaluating mortgage-backed bonds or corporates, investment grade or high yield. Perhaps more important, the dispersion of credit spreads among corporate issuers has contracted as credit spreads have tightened. Balance sheets are strong and profit margins high, but investors are rewarded with less incremental yield for investment in riskier credits.

We agree that spreads are tight relative to recent norms. After all, the level of 72 basis points for average investment grade corporate bond spreads over Treasuries reached in September is the lowest level since the turn of the century. That said, we are also aware that the market needs to tighten an additional twenty basis points to reach the all-time tights of 51 basis points of July, 1997.

Today's environment of rich valuations challenges investors to stay disciplined, diversified, and patient. Selecting lower yielding but stronger credits rather than reaching for yield requires discipline. A well-diversified portfolio is prudent because there is much

more to lose from the collapse of a concentrated position than an advantage gained from appreciation through tighter spreads. Lastly, the patient investor is better positioned to benefit when volatility yields to a more rewarding opportunity in the future, an inevitability that is just a matter of time, especially if the employment picture continues to weaken.

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