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Market Update – *Move Over Mag 7 ~ The Bond Market Takes Center Stage*
by David A. Jaffe, M.D.

Whether up or down, the stock market gyrations of the last three to four years have been consistently driven by investor sentiment regarding the outlook for a handful of “mega-cap” technology companies and forecasts for investment growth in the realm of artificial intelligence (AI). Not so for the third quarter of 2026.

Spurred by inflation worries and rising energy costs, interest rates soared in the most recent quarter. The 10-year U.S. Treasury yield notched its largest 3-month gain since 1994, ending the quarter with the highest interest rate in 24 years. Researchers have noted a level of correlation between the 10-year U.S. Treasury and Oil Prices (Brent Crude) matching that of the 1990 Gulf War.

The Market-Cap Weighted (MW) S&P 500 managed a 2.30% gain for the quarter, AI investment expectations outweighing worries regarding rising interest rates. Absent the levitating power of those mega-caps, the Equal-Weight (EW) S&P 500 felt the pressure of rising interest rates, *declining* 1.87% for the quarter. The PASI stock portfolio, holding a balance of tech and AI-related companies as well as more broadly diversified businesses including health care, financial services, and consumer companies, rose 0.69% for the period.¹ All quoted returns include reinvested dividends.

I’ve often shared with clients my view that bond investments are more complicated than stocks. In the simplest sense, if a company does well and earnings grow, stock prices eventually follow. The nuances of factors influencing interest rates and ultimately the bond market are far more complex. Later on these pages you will find a comprehensive review by our long-time bond manager, Christopher Brown, MBA. The topic is more timely than it has been for many years.

¹ Please see performance disclosure page 10.

The Restaurant at the End of the Universe

by Nathan Polackwich, CFA

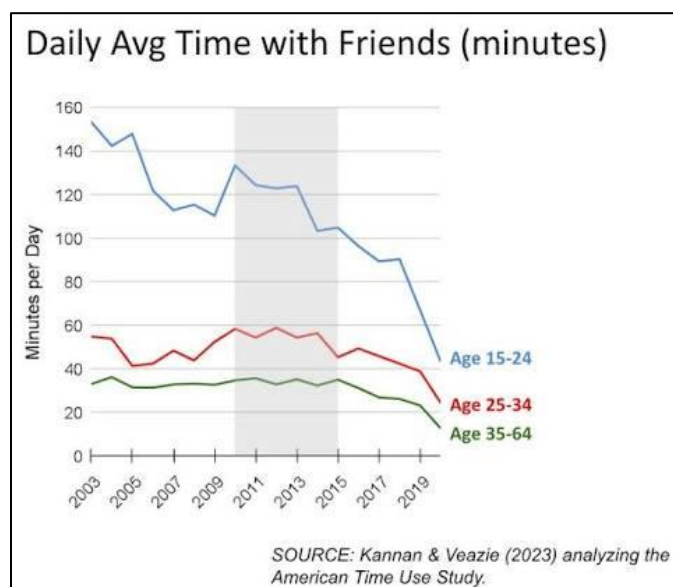
In Douglas Adams' *The Restaurant at the End of the Universe* (the second book in his five-part *Hitchhiker's Guide to the Galaxy* "trilogy"), the invention of time and interstellar travel is used not for anything important but for frivolous activities like traveling to a restaurant in the future to watch the universe's final annihilation over dinner.

The restaurant is a metaphor for the inscrutability of the universe's meaning. Even watching its end gives patrons no deeper insight into its purpose. Instead, they continue to joke, make small talk, and worry about far more human concerns like the social faux pas of accidentally running into another version of themselves visiting the restaurant from a different time.

The book also features an extraordinarily intelligent robot, Marvin, whose vast knowledge and understanding ironically make him miserable, as he's acutely aware of the absurdity, randomness, and seeming pointlessness of the events surrounding him. Marvin's depression is compounded by him continually, and humorously, being given menial tasks far below his abilities. Despite, or perhaps because, he knows so much more than everyone around him, he can enjoy nothing.

Though first published 46 years ago in 1980, the book's themes still resonate today – indeed, with life increasingly mediated by the Internet and now artificial intelligence, perhaps more so. We've invented technology that can deliver all of humanity's accumulated information and wisdom to our fingertips instantly, but most of the time we use it for trivial things like sending each other funny cat videos.

Adams' metaphor isn't meant to paint humans as hopelessly shallow or unwilling to confront existential questions. Rather, it's that since the universe's ultimate purpose defies scientific explanation, meaning must be found elsewhere – whether in faith or, in the case of Adams' characters, at the basic human level of friendship, loyalty, humor, and ordinary pleasures. One of the recurring wishes of the book's main protagonist, an Englishman named Arthur Dent stranded somewhere in the cosmos, is just to find and enjoy a "proper" cup of tea.



While the technology in *The Restaurant at the End of the Universe* is mostly used to facilitate these simple pleasures, in the modern world the direction of technological change has unfortunately made them *less* attainable. An indication of this is the decreasing amount of time people are spending with friends.

The common explanation for this trend is that it reflects the Internet giving people just enough entertainment and simulated social connection that their motivation to leave the house has diminished. That's absolutely true. But at its heart, this is really a story of relative cost between the price of going out and socializing versus staying home. It's become prohibitively expensive, particularly for young people, to regularly meet friends for drinks, eat at restaurants, or attend concerts and other social venues. Conversely, you can watch any movie ever made, play incredibly immersive videogames, or endlessly scroll short videos on social media for little to nothing. I imagine that if a movie at home suddenly cost \$200 while a night out on the town cost \$20, people would have a lot more motivation to leave the house and enjoy the company of friends.

Technological advances, at their core, represent increases in productivity, and we've gotten extraordinarily good at delivering endless digital entertainment for a nominal price. But it's not really possible to meaningfully increase the productivity of a restaurant, bar, or concert. So their prices haven't fallen like those for screen-based diversions. In fact, prices have soared largely *because* of the rapid productivity growth in digital entertainment, as well as other areas of the economy like manufacturing and farming.

The reason is explained by an economic theory called Baumol's cost disease, first identified by the economist William Baumol in the 1960s. While at Princeton, Baumol was trying to determine why performing arts organizations faced persistently rising costs. He realized it was because the industry couldn't materially improve labor productivity. A string quartet will always need four musicians and can't play Mozart any faster or give more performances than it could in the 18th century.

Goods and services can be separated into those where labor productivity tends to increase over time like manufactured goods, technology, and agriculture (Baumol called these progressive sectors) and those where it doesn't like restaurants, childcare, and concerts (stagnant sectors). Progressive sectors naturally see rising wages, as more productive labor generates more income. These gains, however, also force wages higher in stagnant sectors. If, for instance, highly productive manufacturing laborers earned ten times more than those working at a restaurant, most restaurant employees would quit and seek factory employment. This forces restaurant owners – and the owners of other businesses in less productive industries – to raise their employees' wages to more competitive levels. But because their workers aren't more productive than before, these owners see their costs explode and are forced to raise prices. Conversely, in progressive industries, higher wages don't necessarily lead to price increases. A manufacturing company that pays its workers ten times more than before doesn't need to raise prices if the workers are ten times as productive.

I started thinking more deeply about these issues when recently analyzing the annual report of PASI stock holding Sysco (SY), the world's largest foodservice distributor that supplies restaurants, hotels, and other institutions with food and related products. A statistic that jumped

out at me was restaurant traffic (including deliveries) in the U.S. being down roughly 10% since 2011. A big reason is almost certainly the fact that restaurant prices have risen 71% over the same period vs. a 40% increase in grocery prices. Thanks to Baumol's cost disease, this is a trend I unfortunately think may continue.

This doesn't mean that Sysco's stock can't outperform. Research on long-term stock returns has paradoxically shown that industries with rapid labor productivity growth often disappoint investors over the long run. The reason is that they're also usually highly competitive, and investors typically pay too rich a price for high-growth stocks early in the industry's development, leading to poor long-term results.

Although its customers operate in a stagnant end market, Sysco's revenue has actually risen 110% since 2011, as it's benefited from both rising prices and modest volume growth from market share gains. In addition, unlike its customers, the Company has plenty of opportunity to improve the productivity of its workforce thanks to advances like warehouse automation, inventory tracking, and optimizing delivery routes. Conceivably, once autonomous driving is ubiquitous, a relatively small team could efficiently manage Sysco's distribution network across a large region.

While Sysco's in good shape, I don't know that there's a solution to the impact of Baumol's cost disease on the price of socializing outside the home. And digital entertainment is only going to get better and cheaper in the future. So spending time out with friends will have to become increasingly intentional, something we consciously choose despite the convenience and lower cost of the alternatives. As *The Restaurant at the End of the Universe* shows us, there's far more meaning to be found sharing a meal with friends than in passively watching even the greatest spectacle.

Interest Rates: *What goes up must come down...Right?*

by Christopher M. Brown, MBA

Interest rates are one of the most important forces influencing the economy and financial markets. Simply put, higher interest rates make borrowing money more expensive. They affect everything from mortgage payments and auto loans to credit card rates, bond values, and stock prices. Higher rates can slow consumer spending, discourage business investment, and place additional financial pressure on households, particularly those carrying debt or looking to finance major purchases.

But there is a silver lining for investors. After more than a decade of historically low interest rates, cash holdings (think savings accounts and money market funds) and fixed-income investments (bonds) are once again generating meaningful income. For investors in or nearing retirement, who often rely on their portfolios to help fund living expenses, this is a welcome and significant change.

The Federal Reserve, commonly known as the "Fed," sets the country's benchmark short-term interest rate. Its primary goals are to keep inflation under control and maintain a healthy job market. When inflation runs too high, the Fed generally raises interest rates to discourage

borrowing and spending. Conversely, when the economy weakens, it may lower rates to encourage borrowing, investment, and economic growth.

When President Trump nominated Kevin Warsh to chair the Federal Reserve on January 30, 2026, Wall Street, including PASI, anticipated that the Fed would continue lowering interest rates. As the Wells Fargo Investment Institute explained at the time:²

“If Warsh is confirmed, we believe he will advocate to push the federal funds rate to a ‘neutral’ level, which most Fed members project is near 3.00%. This expectation is consistent with our outlook for two quarter-point rate cuts in the second half of 2026.”

Fast-forward to September, and things didn't go quite as expected. Instead of cutting rates, the Fed raised its benchmark interest rate by a quarter of a percentage point, bringing the upper end of its target range to 4.00%. It was the first rate increase in three years.

Why the change? Despite persistent inflation, the economy continued to demonstrate surprising strength. As Bank of America economist Aditya Bhawe explained, a resilient economy gave the Fed room to raise rates to prevent inflation from becoming more deeply entrenched.

However, there is an important distinction investors should understand: The Fed controls short-term interest rates, but it does not directly control longer-term rates, such as those on 10-year U.S. Treasury notes or 30-year mortgages. Those rates are largely determined by investors in the bond market, who weigh inflation expectations, economic growth, government borrowing, and future Fed policy.

Recently, 30-year mortgage rates climbed above 7%, compared with roughly 2.8% in 2021, creating significant challenges for homebuyers and the housing market. Meanwhile, the yield on the 10-year U.S. Treasury surpassed 5.3%, reaching levels not seen in more than two decades.

While those yields may seem unusually high by recent standards, they pale in comparison to the early 1980s, when long-term Treasury yields approached 16% as the Federal Reserve battled runaway inflation despite a struggling economy, a particularly challenging economic environment dubbed “stagflation.”

Fortunately, we're a long way from those extremes, but the lesson remains the same: Interest rates don't always move in the direction investors expect, and even the experts can get it wrong. Several factors are contributing to higher long-term interest rates. First, inflation remains a concern. According to the U.S. Bureau of Labor Statistics, the Consumer Price Index rose 0.6% in September (seasonally adjusted) and 3.7% over the past 12 months (not seasonally adjusted).³ Investors lending money for 10 or 20 years want to be compensated for the possibility that inflation will erode the purchasing power of their future interest payments. Second, the federal government continues to borrow substantial amounts of money to finance its spending and refinance existing debt. Greater borrowing can put upward pressure on interest

² <https://www.wellsfargoadvisors.com/research-analysis/reports/policy/new-fed-chair.htm>

³ <https://www.bls.gov/cpi/latest-numbers.htm>

rates, particularly when investors demand higher yields to absorb the additional supply of Treasury bonds.

With the national debt reaching approximately \$40 trillion and the debt-to-GDP ratio approaching 120%, concerns about the nation's fiscal outlook are growing. Add to that the ongoing conflict with Iran and its impact on oil prices, and it is easy to understand why investors are feeling uncertain. This combination of inflationary pressures, rising government debt, and geopolitical instability can lead investors to demand higher interest rates as compensation for taking on additional risk.

Despite these concerns, the U.S. economy continues to show remarkable resilience, thanks in part to massive investment in artificial intelligence (AI) infrastructure. Corporate earnings have also remained strong. In fact, third-quarter earnings for companies in the S&P 500 are expected to grow an impressive 29.6% compared with the same quarter last year.⁴ If that forecast holds, it would mark the third consecutive quarter of earnings growth exceeding 25% and yet another record high for the index's earnings.

For investors seeking more income from their portfolios or looking to balance the risks of stocks with more stable investments, higher interest rates present a welcome opportunity. For much of the decade following the 2008 financial crisis, investors struggled to earn meaningful returns on high-quality bonds. In fact, from mid-2020 through mid-2021, many high-quality bonds yielded around 1% or less.

Today, PASI can offer clients investment-grade corporate bonds with significantly more attractive yields, generally ranging from 4.5% to 6% annually when held to maturity.⁵ This presents an opportunity to lock in attractive income for years to come, at yield levels that have been difficult to find for much of the past two decades.

While earning higher interest on new bonds is certainly appealing, there is a downside to rising rates. When interest rates rise, the market value of existing bonds generally falls. This is because newly issued bonds offer higher yields, making older bonds paying lower rates less attractive to investors. Generally, the longer a bond has until maturity, the greater its price decline when interest rates rise, as existing bonds must adjust in price to remain competitive with newly issued securities.

At PASI, we have always been mindful of the additional risks associated with longer-term bonds. That is why we generally focus on shorter maturities and build diversified bond ladders spanning one to seven years. By staggering maturity dates, typically with a bond maturing approximately every quarter,⁶ we create a steady stream of cash that can be reinvested at prevailing interest rates. Since we generally hold bonds to maturity, this approach allows us to take advantage of higher yields as bonds mature, while reducing the portfolio's sensitivity to interest rate fluctuations. Of course, if rates decline, new bonds purchased with those proceeds may offer lower yields.

⁴ FactSet Earnings Insight: <https://insight.factset.com/sp-500-likely-to-report-earnings-growth-above-35-for-q3>

⁵ Approximate bond yields currently available with bond maturities in the range of five to seven years.

⁶ Smaller accounts may have fewer bonds and less frequent maturities.

For example, suppose an investor owns a bond paying 4% interest. If newly issued bonds of similar quality and maturity begin offering 5%, the older bond becomes less attractive, causing its market value to decline. The reverse is also true. If market interest rates fall, bonds paying higher fixed rates generally become more valuable.

For PASI clients, who generally hold individual bonds to maturity, these short-term price fluctuations are less concerning. As long as the issuing company makes all scheduled interest payments and repays the principal at maturity, investors receive the yield to maturity established when the bond was purchased, regardless of interim market price fluctuations.

Interest rates also influence the stock market, although the relationship is less straightforward. Higher interest rates increase borrowing costs for businesses and consumers, potentially slowing economic growth and corporate profits. They can also make bonds more attractive relative to stocks, particularly when investors can earn competitive returns from high-quality fixed-income investments.

Additionally, higher interest rates can put downward pressure on stock valuations because investors place a lower value on profits expected far into the future. This is particularly important for fast-growing companies, such as many technology stocks, whose valuations depend heavily on earnings they expect to generate years down the road.

However, higher interest rates do not automatically mean lower stock prices. If rates are rising alongside a strong economy and growing corporate profits, as we have seen recently, stocks can still perform well. Ultimately, corporate earnings, valuations, and the overall health of the economy remain the most important drivers of long-term stock returns.

Predicting the direction of interest rates is difficult, even for professional economists and Federal Reserve officials. Inflation, economic growth, government borrowing, and investor expectations will all influence where rates go next. Rather than trying to anticipate every move by the Fed, we believe investors are better served by focusing on the opportunities available today.

Higher bond yields provide an opportunity to generate meaningful income, while a diversified portfolio of stocks and bonds can help balance long-term growth with stability. At PASI, our approach has never been about predicting short-term market movements, but rather building portfolios designed to weather changing economic conditions while keeping our clients' ultimate financial goals in focus.

Interest rates will rise and fall, and the headlines will continue to speculate about what the Fed will do next. Fortunately, successful investing doesn't require a crystal ball. It requires discipline, diversification, and patience.

RMD Time: *Uncle Sam's Favorite Season*

by Jordan Bieber, CRPC®, ChFC®

You spent decades diligently tucking money away, deferring taxes, and watching your nest egg grow. But eventually, the IRS comes knocking with a gentle reminder: *those tax-deferred retirement accounts were a partnership, and Uncle Sam is ready to collect his share.*

Welcome to the season of Required Minimum Distributions (RMDs).

Whether you are enjoying full retirement or still actively working, recent legislation under the SECURE Act and SECURE 2.0 has overhauled the timeline and rules. Here is a breakdown of what you need to know to stay compliant, keep penalties at bay, and optimize your year-end distributions.

When Must You Start?

Your mandatory starting age depends entirely on the year you were born:

- **Born in 1960 or later:** Age 75
- **Born between 1951 and 1959:** Age 73
- **Born between July 1, 1949 and Dec 31, 1950:** Age 72
- **Born before July 1, 1949:** Age 70½

RMD Rules at a Glance: Account Types, Employment, and Deadlines

How and when you take your distributions depends heavily on whether you are retired, still on the job, or own a stake in the business you work for:

Critical Considerations Before Year-End

- **The >5% Ownership Rule:** If you own more than 5% of the company sponsoring your retirement plan, the IRS does not allow you to use the "still-working" deferral. You must take your 401(k) RMDs once you hit your designated age, even while drawing an active paycheck.
- **Old 401(k)s Don't Get a Pass:** The still-working exception applies *only* to the plan sponsored by your **current** employer. Qualified accounts left behind at prior companies are subject to annual RMDs regardless of your current employment status.
- **The First-Year Deferral Trade-Off:** While you have the flexibility to delay your first RMD until April 1st of the following calendar year, doing so means you must satisfy **two RMDs within a single tax year** (the deferred first payout plus your regular second distribution by December 31st). Because this combined income can push you into a higher tax bracket or trigger Medicare premium surcharges, this timing choice should be evaluated carefully to determine whether deferring or taking your initial distribution in year one minimizes your overall tax burden.

Execution Checklist for October

1. **Audit All Accounts:** Identify which accounts require distributions for 2026 (Traditional, SEP, SIMPLE IRAs, and active/inactive workplace plans).

Client Category	RMD Status	Deadlines
Fully Retired <i>(Reached RMD age)</i>	Required	Initial RMD: April 1 following RMD age year or retirement year, as applicable Subsequent RMDs: December 31 annually
Still Working: Non-Owner or ≤5% Owner <i>(Reached RMD age)</i>	IRAs / Former Employer Plans: Required Current Employer Plan: Still-working exception may delay RMDs until retirement, if permitted by plan	IRAs / Former Plans: Initial RMD by April 1 following RMD age year; subsequent RMDs December 31 annually Eligible Current Plan: Initial RMD by April 1 following retirement year; subsequent RMDs December 31 annually.
Still Working: >5% Business Owner <i>(Reached RMD age)</i>	Required Ineligible for still-working exception on plans of businesses in which ownership exceeds 5%	Initial RMD: April 1 of the year following RMD age year Subsequent RMDs: December 31 annually

Notes:

- 1) Still-working exception applies only to eligible current-employer plans, subject to plan provisions. Deferring the initial RMD until April 1 requires two RMDs in that calendar year.
- 2) Roth IRAs and Roth 401(k) accounts are exempt from lifetime RMDs for the original owner.
- 3) 25% excise tax on the RMD shortfall. Reduced to 10% if corrected within the applicable correction window. The IRS may waive the penalty for reasonable error.

2. **Explore Charitable Offsets:** If you are age 70½ or older and do not need the extra cash flow, direct transfers via a Qualified Charitable Distribution (QCD) can satisfy your RMD without adding a dime to your adjusted gross income.
3. **Review Tax Withholding:** The option exists to have your IRA custodian withhold federal and state taxes when IRA distributions are processed. You should confirm with your accountant whether taxes should be withheld directly from your distribution or handled via estimated payments.

Our team will be in touch with all clients carrying outstanding 2026 RMDs over the next few weeks to verify calculations and ensure everything is processed well ahead of the December deadline.

Disclosure

Professional Advisory Services, Inc. may, from time to time, have a position in securities mentioned in this newsletter and may execute transactions that may no longer be consistent with this presentation's conclusions. Reference to investment performance of the PASI composite stock portfolio is made gross of expenses. For formal performance disclosure with net returns please contact our office.

Performance Disclosure

To obtain a detailed analysis of Professional Advisory Services, Inc.'s (PASI) historical performance, inclusive of gross and net results from our balanced accounts and performance data for our segregated asset classes, please contact our office at 800-847-7274. It is important to note that PASI performance data presented in this newsletter is stated before the deduction of fees and in the context of each article. For a clearer understanding of the impact of fees, please refer to the following disclosures including a hypothetical example based on the maximum PASI investment management fee.

The **PASI Stock Portfolio** includes the reinvestment of dividends; and is reduced by brokerage commissions but is gross of Professional Advisory Services, Inc. fee, which is described in Part II of Form ADV, available upon request. Our fee is a maximum of 1% and decreases based on assets under management. As an example of fee impact, over a ten-year period, \$100,000 invested in stocks growing at 8% per year would increase at the end of ten years to \$205,419 net of 1% fee versus \$220,804 gross return.

PASI Stock Portfolio Benchmark: The *S&P 500 Index (Market-Cap-Weighted)* is an unmanaged index of the 500 leading publicly traded common stocks in the U.S., including reinvestment of dividends. This index is weighted according to the market capitalization of each participating company. As a result, companies with larger market capitalizations exert greater influence on the index's overall return, reflecting their proportionate size to the overall market.

Other Indices: The *S&P 500 Equal Weight Index (Equal-Weight)* is an unmanaged index of the 500 leading publicly traded common stocks in the U.S., including reinvestment of dividends. Designed to be size-neutral, it assigns equal weight to each participating company, irrespective of their market capitalization. This approach equally captures the influence of each company on the index's overall return relative to its individual performance, providing a balanced reflection of the collective market activity.