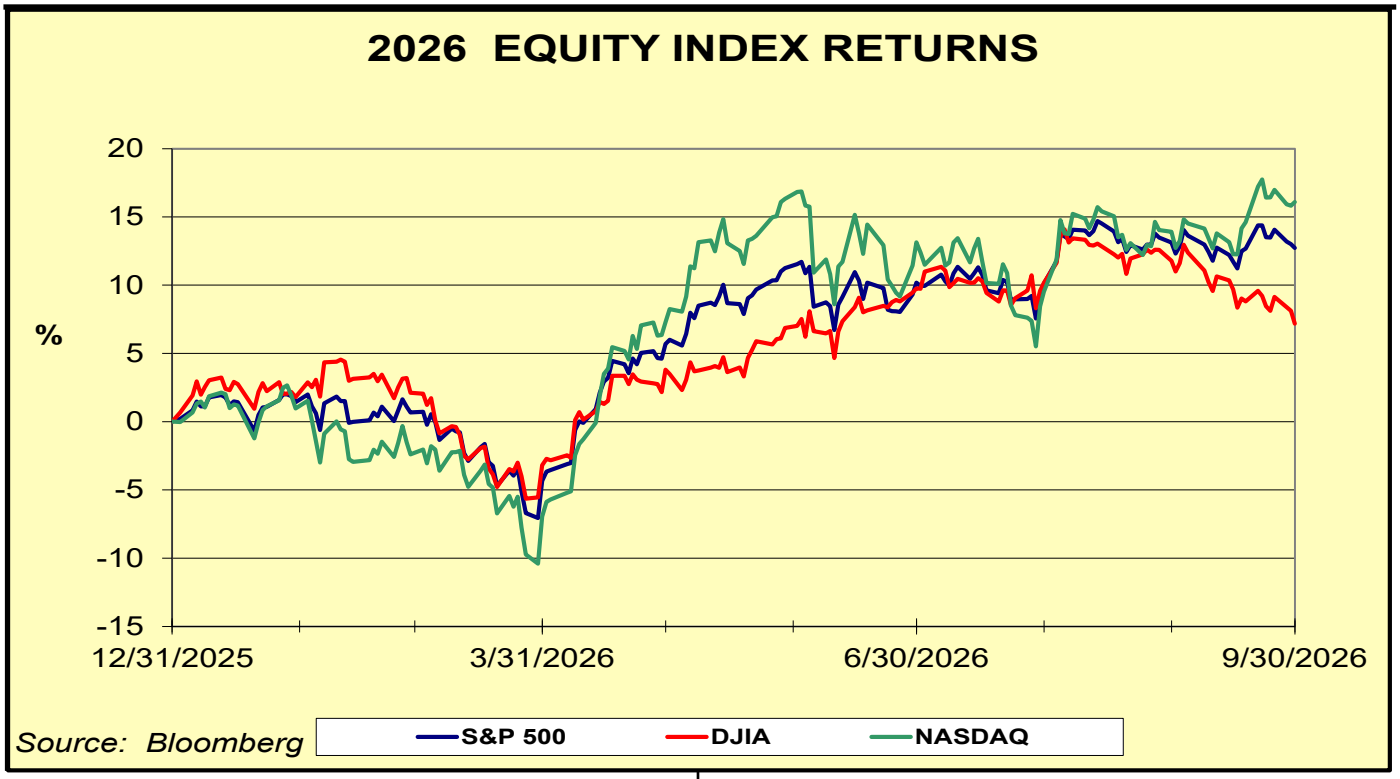
WINDWARD CAPITAL

Risk Averse Asset Management

2026 Third Quarter Review

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Situationally Unaware

"Show me the incentive, and I'll show you the outcome."

— Charlie Munger (1924 - 2023)
American Businessman and Investor

During the Third Quarter of 2026, the major U.S. equity market indices moved sideways, with the Standard & Poor's 500 Index (S&P 500), Dow Jones Industrial Average (DJIA), and NASDAQ Composite Index (NASDAQ) returning +2.30%, –2.34%, and +2.61%, respectively, for the period. As a result, for 2026 Year-to-Date, the S&P 500, DJIA, and NASDAQ have returned +12.73%, +7.19%, and +16.09%, respectively.

Global financial markets have experienced significant volatility over the last 21 months—particularly in 2025, but also now in 2026.

This financial market volatility appears to continue to be related to the ongoing significant uncertainty regarding the conflict in the Middle East and the impacts of tighter monetary policy, inflation, and geopolitical trade conflict on the global macroeconomy and the resultant effect that these issues could have on the corporate revenue and earnings outlook, as well as several market-related risk factors, including, among others, speculative excesses, above-average market valuations, unjustified economic sector rotation, and the narrowness of the market advance.

Overall, however, financial market participants have chosen, by and large, to continue to ignore most of these uncertainties and risks.

It appears that, recent volatility notwithstanding, this positive market momentum is due to financial market participants' "fear of missing out" (FOMO) on current, and future, equity market advances driven primarily by the stocks of companies that they believe are beneficiaries of the boom in Artificial Intelligence (AI) capital spending (indeed, some of these stocks are up over +1000% from the April 2025 market lows). Whether these expectations will be fully met remains uncertain, however: although we agree that, as it has over the previous several decades, AI has the potential to make a significant societal and economic impact, there are currently no signs of AI benefits in the U.S. economic productivity data:

Total Factor Productivity (TFP) measures how much output the economy produces from a given quantity of labor and capital. It is what remains of growth after accounting for more hours worked and more machines installed. When firms produce more without adding inputs, TFP rises. For that reason, it is the closest available proxy for technological progress and for genuine improvements in how inputs are combined.

Labor Productivity, or output per hour, is a different concept. It can rise for three main reasons: workers are given more or better equipment ("capital deepening"), the composition of the workforce shifts toward higher-skilled labor, or TFP improves. Only the third option reflects true innovation, in our opinion.

That distinction is central to the current AI thesis. Hundreds of billions of dollars of investment are flowing into data centers, semiconductors, and model training. By definition, that capital deepening should mechanically lift output per hour. The more interesting question is whether this AI spending is also raising TFP—meaning, is the spending justified because it is making the economy fundamentally more efficient?

So far, the data indicate that it is not. Per the Federal Reserve Bank of San Francisco, utilization-adjusted TFP is currently sitting slightly below +0% with no sign of acceleration since the AI capital expenditure (capex) cycle began in early 2023. Labor productivity, by contrast, is running at slightly over a +2% annualized rate, in line with its post-1947 average—and that strength is exactly what gets cited as evidence that AI is already working. But strong output per hour alongside flat TFP is a sign of *capital deepening*, not of a positive technological productivity shock.

At the moment, then, the AI boom is clearly visible in investment data and in equity valuations, but it is not yet visible in the productivity statistics—which means that the ultimate benefit from AI remains a forecast rather than an observation.

The current macroeconomic (and financial market) debate surrounding a potential AI investment "bubble" is centered on whether historic levels of infrastructure capex can be sustained by real-world enterprise adoption. While some analysts maintain that valuations are supported by robust technology corporate cash flows, we believe that there are several fundamental speculative vulnerabilities driving the current AI investment thesis that span financial, operational, and structural risks. These include, among others:

Financial Risks

- The monetization-to-capex gap
- Negative free cash flow dynamics
- Circular financing and questionable accounting issues
- Exotic off-balance sheet leverage

Operational and Economic Realities

- Deteriorating unit economics
- Severe subsidization losses
- Low-to-negative returns on invested capital
- Rapid asset depreciation
- Commoditization and lack of competitive "moats"

Physical and Structural Bottlenecks

- Significant power grid constraints
- Local regulatory delays and permitting backlash
- Surging debt costs

These risks can be combined with myriad other issues, including poor quality management, suspect

corporate behavior, and misleading financial metrics, to name just a few.

We continue to believe that successful (and profitable) future AI business models remain mostly undetermined at this time and that the market is ahead of itself in determining which companies will be the long-term "winners." Indeed, today's AI boom shares many of the characteristics we witnessed during the Tech/Media/Telecom boom (and bust) of the late 1990s.

As a result, the equity market advance over the last several years has been very concentrated: specifically, the top seven companies (by market capitalization) in the S&P 500 Index as of September 30, 2026 represent 36% of the total Index—significantly higher than the 22% recorded as of December 31, 2022. The top 10 companies in the S&P 500 Index as of September 30, 2026 represent 41% of the total Index, compared to 26% at the end of 2022. Importantly, all of these companies are in the Information Technology sector.

Although returns of the market-weighted S&P 500 Index and the S&P 500 Index on an equal-weighted basis are broadly similar for 2026 Year-to-Date (increasing +12.73% and +10.01%, respectively), the equal-weighted S&P 500 Index has dramatically underperformed the market-weighted Index's most recent advance. Indeed, the market-weighted Index's top-line line results mask significant underlying volatility that has occurred throughout 2026 within the components of the S&P 500—including dramatic rotation and changes in "leadership" across a variety of economic sectors.

Further, the 52-week correlation between the equal-weighted S&P 500 and the market-weighted S&P 500 is down to 0.67, its lowest level on record. This statistic measures how closely the performance of the equal-weighted index tracks the market-weighted index, with a lower reading indicating a growing gap between the broader market and mega-cap stocks. By comparison, before the 2020 pandemic, this metric remained between 0.95 and 0.99 (i.e., highly-correlated) for nearly 15 years. During the "dot-com" bubble, this correlation never declined below 0.85.

In addition, other indicators—such as a faltering McClellan Index (which consists of two primary market breadth indicators), a downtrend in the influential Financials economic sector, and weakening Mid- and Small-Cap Indices—suggest to us that the overall equity market's advance is narrowing further.

Despite the S&P 500 Index trading near all-time highs, 84% of S&P 500 stocks are now trading at least –10% below their respective all-time highs. Furthermore, 59% of S&P 500 stocks are down at least –20% from their highs, 41% are down more than –30%, and 17% are down more than –50%. We do not believe that these are signs of a healthy market advance.

The gap between AI-related names and the rest of the market is historic: Since the start of 2024, a basket of 42 AI stocks has generated 67% of the S&P 500's price return. Additionally, those 42 AI stocks have accounted for 58% of the S&P 500's earnings growth and 81% of capex and research & development growth since the start of 2024. Meanwhile, only 29% of stocks have outperformed the S&P 500 over the last three years—close to the 25% low recorded during the 2000 "dot-com" bubble.

Historically, this type of narrowness and divergence in returns is not usually sustainable—and is typically resolved either by a correction of the leading stocks and/or by gains of the lagging stocks (a "broadening out"). Indeed, index concentration of this magnitude has typically proven self-correcting, with some combination of regulatory, market, and/or competitive forces—along with business cycle dynamics—undermining static leadership (cf. the late-1960s to early-1970s "Nifty Fifty" stocks and the late-1990s to early-2000 "dot-com" stocks). We therefore expect that any resulting potential convergence, or "mean reversion," may lead to additional market volatility in the coming months.

Previously, despite ongoing risks, the U.S. economy had remained in a relatively strong position among the Group of Seven (G7) (a group of the world's leading industrialized democracies) and continued to be supported by factors that we have discussed in the past, which included employment-driven increases in household income and the substantial net worth of

the household sector. However, whether or not the U.S. economy retains this relative strength in the face of the Trump Administration's economic policies and geopolitical actions is now uncertain. Indeed, given the elevated uncertainty regarding the ongoing scope and timing of the Administration's Middle East actions and continuing changes to trade, immigration, fiscal, and regulatory policies—and the resultant effect that these issues could have on the corporate revenue and earnings outlook—financial market volatility may continue.

Despite the recent market volatility associated with these policy announcements and geopolitical actions, we currently believe that they do not present a systemic risk to the overall financial markets at this time. In our view, the current financial market volatility is primarily related to the uncertain outlook for global macroeconomic growth as it relates to issues that we have discussed with you previously as well as to additional directives promulgated by the Trump Administration.

As we have discussed for several years, some of the factors providing underlying support to the U.S. economy over the last few years have also had the unintended consequence of creating speculative excesses and unjustified economic sector rotation in specific areas of the financial markets. Recent examples include trading activity in various commodities and Asian equity markets, as well as in near-bankrupt companies, microcaps, penny stocks, cryptocurrencies, non-fungible tokens (NFTs), special purpose acquisition companies (SPACs), and thematic ETFs, among other financial instruments. Liquidity effects, excessive leverage, and momentum "investing" have combined with high-frequency trading, algorithms, the pervasive use of ETFs, and a variety of social media-driven commission-free retail trading platforms to exacerbate financial market volatility. The emerging use of "prediction markets" to facilitate alleged insider trading related to Trump Administration policy announcements has heightened these trends while creating the potential for financial market manipulation.

Indeed, some financial market participants appear to have adopted a casino-like trading mentality and have never been more eager to ratchet up their stock returns through margin loans and funds that amplify gains and losses. U.S. margin debt, or what investors borrow from their brokerages to buy securities, rose +37% to a record $1.5 trillion in August 2026 from a year earlier, according to FINRA data. Meanwhile, high-risk leveraged ETFs that produce double (or even triple) the daily move of underlying stocks are growing rapidly, as is trading in options tied to them. These funds, along with other forms of leverage, can affect how the individual stocks behave as the funds purchase derivatives linked to single stocks and related indices. Those purchases in turn spur demand for underlying shares from market makers, which buy stocks to hedge their exposure to the derivative contracts they write. If a leveraged fund grows large enough, it can start to have a significant impact on the underlying stock to which it is tied, thereby increasing volatility.

Several of these factors have also led to indications of stress in opaque and illiquid asset classes—specifically, in certain segments of the credit market. Leveraged loan prices for some computer software firms have declined sharply in recent months because of concerns regarding their business models' potential vulnerability to AI disruption. As a result, there have been notable increases in redemption requests at several private credit funds because of their high exposure to software-related business loans. Unfortunately, these funds provide their investors with limited liquidity and usually restrict redemptions. Given that the current size of the private credit market is estimated to be at least $1.7–$1.8 trillion, stress in this area of the financial markets bears close monitoring for the potential risk of contagion.

The ultimate unwinding of these speculative excesses and rotational sector moves may result in increased volatility and, potentially, a near-term market correction. (Indeed, although parabolic advances in stock prices may carry further than expected, they usually do not correct by going sideways.) This is especially evident during periods of excessive uncertainty—as in the current environment.

During such periods, our decades of investing experience through a variety of market cycles (and corrections) have taught us that the best approach is to remain unemotional and dispassionate as we continu-

ously evaluate whether there are any material impacts to the long-term fundamentals of the businesses that we own. It is worth noting that extraordinary investment opportunities are often created during such extreme changes in investor sentiment.

We continue to believe that the risk associated with any resultant financial market volatility is mitigated in *Windward* portfolios—especially over the long run—to a large degree by the fact that we are invested in businesses that we believe to be leading companies that have high quality standards from a financial and management perspective, high incremental returns on invested capital, and business models with competitive advantages.

Historically, periods of excessive ex-ante savings, combined with demand that is too weak to justify investment, cause certain areas of the financial markets to become driven by the speculative rearranging of portfolios rather than by the underlying business fundamentals (like return on capital investment). We are not "traders;" we are investors. As such, it is irrelevant to us whether or not "the market" agrees with us over the short term. For speculators, on the other hand, daily market affirmation remains essential.

Although our strategies may underperform relative to the market indices over the short term given the degree to which other market participants make ungrounded assumptions and/or high-frequency trading and algorithmic "investment" strategies engage in daily speculative financial market trading, we believe that we will continue to be successful in making profitable long-term investments for *Windward*'s portfolio strategies.* In our view, one of the best ways to accumulate wealth over the long term continues to be by investing in high quality businesses—especially during periods of financial market volatility when investors can take advantage of valuation discounts to purchase such businesses "on sale."

As you know, *Windward*'s goal is to help protect our clients' capital and mitigate market-related risks by investing in specific, high-quality businesses that have long-term, secular growth opportunities. Indeed, we prefer to take a proactive approach to managing risk by investing in companies that are taking advantage of the changes in their operating environment to create long-run opportunities for their businesses. Our long-term performance results demonstrate the effectiveness of our disciplined investment approach.*

As always, we continue to monitor domestic and international political and economic developments as they unfold. As a result, from our long-term perspective, ongoing equity market volatility continues to revolve around numerous global macroeconomic and geopolitical risks that we have elucidated upon in the past. We closely monitor these, as well as other, risks when managing *Windward*'s portfolios of investments. Since we take a long-term view, we typically do not react to short-term financial market fluctuations driven by near-sighted market participants. However, should there be a change in the global macroeconomic indicators and/or corporate fundamentals that we monitor, we are prepared to take whatever action is necessary to help protect our clients' capital.

Resilient

Prior to the recent self-inflicted financial market turmoil and trade disruption caused by the Trump Administration's tariff announcements and declaration of war in the Middle East, the U.S. economy was on track to reach an "immaculate disinflation" outcome, whereby inflation decreases without causing a recession or significant unemployment increases. However, some economic trends that we have discussed in detail with you in previous *Windward Quarterly Review*s have shifted:

Inflation

As we have discussed for some time now, several economic and industry-specific indicators suggest that U.S. inflation peaked in 2022. The subsequent decline in inflation over the next few years was a result of tighter financial conditions, ongoing progress in matching supply/demand imbalances, a moderation in economic growth, and demand destruction, among other factors.

Unfortunately, although there has been further progress in certain core inflation statistics, some components appear to be persistent and remain above the U.S. Federal Reserve's (Fed's) +2% longer-run goal.

Over the 12 months ending in August 2026, Total Personal Consumption Expenditures (PCE) prices rose +3.4%—a significant decline from the June 2022 peak of +6.8%. Excluding the volatile food and energy categories, Core PCE prices rose +3.0% over the 12 months ending in August 2026 (down from the February 2022 peak of +5.4%).

Over the 12 months ending in September 2026, Total Consumer Price Index (CPI) prices rose +3.7%, while Core CPI prices, which excludes food and energy, rose +2.6% over the same period.

After peaking at +6.48% year-over-year in September 2022, "supercore" inflation (inflation in core Services other than Housing)—which constitutes more than half of the Core PCE index and may be the most important category for understanding the future evolution of Core inflation—gradually declined nearly every month since then to a three-year low of +2.67% year-over-year as of January 2026. Unfortunately, as of September 2026, this metric has risen to a rate of +3.13%.

The Federal Reserve Bank of Atlanta's Sticky-Price CPI Tool, an economic indicator that tracks the prices of goods and services that change relatively infrequently (discussed in further detail in the *Windward 2026 Second Quarter Review*) rose +3.4% on an annualized basis in September 2026. On a year-over-year basis, the series is up +2.8%. On a Core basis (excluding food and energy), the Sticky-Price Index rose +3.5% (annualized) in September 2026, and its year-over-year change was +2.8%.

While having declined from the 2022 peak, most of these inflation statistics have *increased* since the April 2025 lows (primarily because of the Trump Administration's trade and immigration policies) and could increase further given the lingering and/or potential first, second, and third order economic effects from the Middle East war. There is considerable uncertainty, though, about the timing, size, and duration of these effects.

While it is understandable that rising oil and gasoline prices have garnered many of the headlines regarding recent inflation metrics, the increase in service sector prices (i.e., "supercore" inflation) pre-dated the recent energy supply shock caused by the Middle East conflict and should be a focus when it comes to analyzing longer-term inflation trends. Persistent service sector inflation is one of several important parts of an economic mosaic that we believe will feed into the conversation around the probability of rate hikes by the Fed later this year and into 2027.

It is also important to note that, although the *rate* of inflation has declined over the last few years from its 2022 peak, the overall *level* of prices remains higher than before the pandemic, pressuring affordability and eroding standards of living: per the U.S. Bureau of Labor Statistics (BLS), since February 2020 (immediately pre-pandemic) through August 2026, U.S. consumer prices have risen approximately +30%.

Employment

Although U.S. labor market conditions remain relatively stable, certain components have continued to soften.

Each year, the U.S. Bureau of Labor Statistics (BLS) Current Employment Statistics (CES) employment estimates are benchmarked to comprehensive counts of employment from the Quarterly Census of Employment and Wages. These counts are derived primarily from State unemployment insurance tax records that nearly all employers are required to file with State workforce agencies. The preliminary benchmark revision reflects the difference between two independently derived employment counts, each subject to their own sources of error, and it serves as a preliminary measure of the total error in CES employment estimates from the previous 12 months, ending in March of the current year. (The final benchmark revision will be issued in February 2027 with the publication of the January 2027 Employment Situation news release.)

The recently-released preliminary estimate of the CES national benchmark revision to total nonfarm em-

ployment for the 12 months ended March 2026 was a *decrease* of –79,000. As a result, after the most recent BLS benchmark revisions, U.S. payroll growth, on a three-month moving average basis, increased from +20,000 per month in March 2025 to +68,000 per month in March 2026. (note that March 2025 U.S. payroll growth, on a three-month moving average basis, had previously been reported at +174,000 before its benchmark revision.)

Most recently, in September 2026, the U.S. economy generated +29,000 new jobs, while the unemployment rate was 4.2% (still near a historic low) compared to 4.0% in January 2025 and 3.7% in January 2024. Notably, there have been total *downward* employment revisions of –118,000 for April 2026 through August 2026 (not part of the BLS benchmark revision period). As a result of these downward revisions, U.S. payroll growth, on a three-month moving average basis, declined to a rate of +51,000 in September 2026 from a rate of +61,000 in January 2026.

The current U.S. employment environment continues to be characterized as "low hire/low fire." According to recent Fed research, labor force growth has been slowing and could approach zero starting this year, driven by weak population growth (reflecting low net immigration) and by declining labor force participation (reflecting population aging). Such weak growth in the labor force is unprecedented in the United States' recent history. (We discussed possible economic ramifications of this potential shift in the *Windward 2026 First Quarter Review*.)

The impact of tariffs and restrictive immigration policy on hiring is undeniable, in our opinion: since May 2025, these policies pushed economic uncertainty to the highest level in years. As a result, U.S. employment expanded by a mere +116,000 in 2025—its weakest annual pace since the declines experienced during the Coronavirus pandemic in 2020 and the global Financial Crisis in 2009.

In addition, part-time employment has been rising, along with the ranks of multiple-job holders. This reflects both the lower quality of jobs available and a need for more income, in our opinion.

Although monthly Nominal Average Hourly Earnings growth has remained relatively steady at an average of +4.0% since the beginning of 2023, it was recently lower at +3.0% on a year-over-year basis in September 2026. More importantly, *Real* Average Hourly Earnings growth declined –0.7% on a year-over-year basis in September 2026 and has been negative for six consecutive months (since April 2026). U.S. workers have seen their Real earnings systematically eroded as broader inflation metrics have outpaced employer pay increases. As a result, households, in aggregate, continue to support their spending by drawing down their savings and/or increasingly relying upon credit.

The post-pandemic economic recovery continues to be "K-shaped"—whereby high-income earners and owners of assets have done disproportionately better than low-income earners. (This type of recovery exacerbates wealth inequality, which can lead to a decline in a country's standard of living.) Food and energy price increases resulting from the Middle East conflict could put further pressure on the low-income demographic.

On a positive note, other labor market indicators—such as the ratio of job vacancies to unemployed workers, the percentage of unemployed workers who find a job, the quits rate among employed workers, and the layoff rate—indicate that there is currently no sharp deterioration in overall labor market conditions.

While job growth typically turns negative when the economy is heading into a recession, based upon a variety of economic indicators that we monitor, we do not believe that a recession is imminent. Rather, current labor market dynamics are a function of both cyclical and structural factors, with trade and immigration policies as the locus. Pervasive uncertainty driven by the Trump Administration's trade and immigration policies is the primary impetus behind reduced demand for workers. At the same time, supply-side factors driven by restrictive immigration policies and demographic changes (i.e., retirement of baby boomers) will continue to constrain the ability of firms to find workers.

Gross Domestic Product (GDP)

For 2025, U.S. Real GDP increased at a +2.2% annualized rate—significantly lower than 2024's +2.8% rate and 2023's +2.9% rate.

For the First and Second Quarters of 2026, U.S. Real GDP increased at +2.5% and +2.1% annualized rates, respectively (after increasing at a +0.2% annualized rate in the Fourth Quarter of 2025). In the Third Quarter of 2026, the Federal Reserve Bank of Atlanta's most recent *GDPNow* forecast predicts that annualized U.S. Real GDP increased by +3.6%. Private forecasters' estimates are around +2.5%.

Real Private Domestic Final Purchases (PDFP)—which comprises PCE and Private Fixed Investment, and which often provides a better signal than GDP of underlying economic momentum—increased at a +2.8% annualized rate for 2025, compared to +3.1% in 2024 and +2.6% in 2023. For the First and Second Quarters of 2026, Real PDFP increased at +1.8% and +4.6% annualized rates, respectively, and the Federal Reserve Bank of Atlanta's most recent Nowcast predicts that annualized Real PDFP increased by +4.5% in the Third Quarter of 2026. (The substantial acceleration from +1.8% in the First Quarter of 2026 to +4.6% in the Second Quarter highlights that underlying consumer spending and business fixed investments are significantly stronger than what top-line GDP figures might suggest. Headline GDP numbers have been heavily dragged down by volatile fluctuations in international trade [surging imports] and adjustments to private inventory levels.)

A modest economic tailwind fueled by the Trump Administration's deficit-financed expansionary fiscal policies (including more-favorable tax provisions, the full expensing of investments, and deregulation, among other elements) could push overall U.S. economic growth to an above-trend rate in 2026. However, persistent inflation pressures (exacerbated by the Middle East conflict), ongoing labor market challenges (including restrictive immigration policies and aging demographics), and the nature of the K-shaped economy's "affordability" issues, among other risk factors that we have discussed in the past, could present significant headwinds that offset this momentum.

Corporate Revenues and Earnings

For 2025, S&P 500 companies reported year-over-year growth in revenues and earnings of +7.6% and +14.1%, respectively. The consensus (according to FactSet) currently expects S&P 500 companies to report year-over-year growth in revenues and earnings of +12.4% and +29.6%, respectively, for the Third Quarter of 2026, and +12.5% and +32.7%, respectively, for calendar 2026, primarily led by results of companies in the Information Technology sector.

In terms of valuation, the forward 12-month Price-to-Earnings (P/E) ratio for the S&P 500 is 19.1. This P/E ratio is below the 5-year average of 19.8 and equal to the 10-year average of 19.1. The trailing 12-month P/E ratio for the S&P 500 is 26.0. This P/E ratio is above the 5-year average of 24.4 and above the 10-year average of 23.6.

Although the available data suggest that the U.S. economy should continue to grow above its historical long-term rate of approximately +2% over the near term, we continue to see upside risks for inflation and downside risks for the labor market. We cannot rule out scenarios with larger and more persistent tariff effects and/or geopolitical impacts on inflation. At the same time, there are signs that it is taking longer for some new entrants in the labor market to find jobs, and that firms are becoming more cautious and selective in their hiring. Outside of AI infrastructure, we also continue to see businesses pausing or delaying projects, especially large ones, in the face of high uncertainty. This "wait-and-see" approach could slow activity further, especially if risk sentiment in financial markets deteriorates and the furious pace of AI investment subsides.

Less Talk, More Walk

As you may recall, the Fed reduced the short-term Federal Funds (Fed Funds) interest rate by a total of 75 basis points during the last four months of 2025 to a target range of 3.50-3.75% (down from a peak of 5.25-5.50% in July 2023).

On September 16, 2026, the Federal Open Market Committee (FOMC) voted to raise the Fed Funds rate by 25 basis points to a range of 3.75-4.00%.

Some takeaways from Fed Chairman Kevin Warsh's post-meeting press conference after the Fed's decision to raise rates include:

- ✓ The decision was unanimously supported by the Committee members, which Chairman Warsh repeatedly pointed to as evidence that the central bank is resolute in its commitment to getting inflation down. "The plain fact is that inflation is too high and has been for too long," Warsh said.

- ✓ Chairman Warsh declined to discuss whether this rate increase is the first in a series of moves or just a one-off (which would be atypical for the central bank). Instead, he said that this rate increase was about "removing a dose of accommodation so that financial and credit conditions would be more consistent" with the Fed's goals of low, stable inflation.

- ✓ The recent rise in long-term U.S. borrowing costs to multi-decade highs have been a focal point for the Trump Administration. Under Secretary Scott Bessent, the U.S. Treasury took several steps in an attempt to calm the U.S. government bond market, including: doubling its liquidity-support bond buyback program from $2 billion to at least $4 billion per operation, shifting its issuance strategy to more short-term securities, jawboning and talking down the market ("I am the house now"), and intervening in global currency markets to support the Japanese Yen. (All of these attempts at intervention have been—unsurprisingly—unsuccessful.) Asked about what was driving the rise in long-term rates, Chairman Warsh pointed to not only higher economic growth prospects but more competition for capital as Information Technology companies borrow heavily to finance the expansion of their AI capabilities. Notably, he did not convey that concerns about inflation or fiscal policy were behind the recent moves.

- ✓ Chairman Warsh demurred from any questions related to President Trump, who has made clear his desire for lower interest rates. Just days before the September FOMC meeting, in fact, Trump threatened to cut off broad swathes of trade if the Fed did not reduce rates. But as the Fed's move shows, at this juncture inflation remains too significant a problem for them to entertain doing anything other than raising rates or holding rates steady.

In our view, Chairman Warsh had significant ground to make up at the September FOMC meeting. For the most part, he did what was necessary: he gave an intelligible explanation as to why the Fed was raising rates, which somewhat reduced the confusion caused by the new Chairman's previous statements.

But challenges remain. In our view, the economic outlook is becoming increasingly uncertain, yet Fed monetary policy transparency is still in a state of flux.

Over the last several months, Warsh had puzzled investors by talking like an inflation hawk after his appointment in May 2026, then voting against a higher policy rate at both the June and July FOMC meetings. Worse, his stated reasoning was opaque because he explicitly executed a strategy to *reduce* central bank transparency by eliminating forward guidance, rejecting the FOMC members' "dot plot" interest rate projections, and refusing to clearly define what economic data would prompt a rate hike. At the end of August, he offered a straightforwardly hawkish assessment at the Jackson Hole central bankers' conference, which was followed in short order by an elevated inflation reading. With high confidence, financial market participants promptly priced in rate increases, and the fixed income markets responded accordingly by selling off across the maturity spectrum.

Chairman Warsh at least now stands on firmer ground after voting to raise interest rates at the September 2026 FOMC meeting. He emphasized that he is not swayed by single data points and is focused instead on the longer-term trend in prices, which he thinks (supply shocks notwithstanding) have been too high for too long. Moreover, he said the economy is strong, at full employment, and growing satisfactorily, allowing the Fed to safely prioritize price stability. Unlike in June and July, his analysis and his policy choices have come into alignment. And, for the moment, the Fed's policy Committee is backing him up.

According to the Fed's latest Summary of Economic Projections, policymakers have "penciled in" at least one more rate increase in the coming months. Evidently, Warsh has more work to do in this regard because he declines to take part in the dot-plot exercise and strongly objects to "forward guidance." (In his view, presumably, nothing is "penciled in.")

As a result, the connections between incoming economic data and monetary policy choices (the Fed's so-called "reaction function") remain far from resolved, in our opinion. If inflation is currently trending too high, a +25 basis point hike—removing, as Warsh put it, a "dose of accommodation"—is unlikely sufficient to address persistent "supercore" inflation—much less self-induced supply-side shocks (e.g., unilateral, non-targeted tariffs, mass deportations, a Middle East war, and unfunded tax cuts combined with expansionary fiscal policy/stimulus).

But how much higher, as things stand, would the Fed Funds rate need to be? It would help to know how Chairman Warsh and his colleagues assess the neutral (or, equilibrium) rate of interest (the rate which neither adds to nor subtracts from aggregate demand), but Warsh puts this question in the same category as forward guidance: he thinks it is misguided and not worth addressing.

In short, the monetary policy clarity that would best serve the economy remains elusive. However, the decision to raise the policy rate, despite opposition from the White House, does strengthen the Fed's credibility when it otherwise might have been severely strained.

That is why the Trump Administration's attempts to impair the Fed's independence are so feckless. With the potential for inflation and unemployment to simultaneously increase as a result of the Administration's misguided trade and economic policies—and, now, geopolitical actions—this is exactly the moment when financial market participants want a central bank setting monetary policy absent pressure from the political sector. Cutting short-term interest rates significantly into such an economic environment could lead to even higher inflation, higher interest rates, higher unemployment, and slower growth—the worst of all worlds. The ability for monetary policymakers to retain their credibility and focus on longer-term economic goals such as price stability and maximum sustainable employment creates a foundation upon which inflation expectations remain well anchored, thereby increasing the confidence of financial market participants.

Within this context, it is notable that the Federal Reserve Bank of New York's most recent September 2026 Survey of Consumer Expectations shows that households' inflation expectations have increased at the short- and medium-term horizons: Median inflation expectations at the one-year-ahead horizon increased by +0.3% to +3.9%, the highest level since May 2023, and increased by +0.1% to +3.3% at the three-year horizon. Fortunately, households' inflation expectations were unchanged at the longer-term horizon: Median expectations at the five-year horizon were unchanged at +3.0%. (From a monetary policy perspective, it is essential that longer-term inflation expectations remain anchored, a critical sign of the Fed's credibility with the broader public.)

Calibrating appropriate monetary policy is challenging in contexts when projections of inflation call for a tighter policy stance while forecasts of real economic activity call for a looser one. Fortunately, relatively stable overall economic conditions are enabling the Fed to take the time to carefully assess the incoming data and their implications for the economic outlook and the balance of risks to inflation and economic activity before making more significant changes to monetary policy.

As a result, restoring price stability could require maintaining a restrictive monetary policy stance for

some time because the historical record cautions strongly against prematurely loosening policy—even in an environment in which economic growth slows and/or unemployment rises. This could increase the risk of an economic recession. Although reducing inflation could require a sustained period of below-trend economic growth and softening of labor market conditions, restoring price stability is essential to set the stage for achieving maximum employment and stable prices over the longer run. At the same time, monitoring risks and the responsiveness of economic activity to interest rate changes will be important guides in adjusting the pace—and duration—of that transition.

Bondage

Despite the Fed's action on the short end of the yield curve (the graph that plots the interest rates, or "yields," of U.S. Treasury bonds across different maturity dates), the fixed income markets are already doing some heavy lifting in an attempt to enforce discipline on monetary and fiscal policymakers.

Interest rates are rising for reasons beyond a resilient economy: sticky inflation is lifting yields in the front end of the curve, record AI-related debt issuance is pressuring the 2- to 10-year "belly," and fiscal worries are pushing up the 10- to 30-year "back end" maturities.

Given that the U.S. economy is at full employment, will likely grow above trend this year, is on track to run a deficit to GDP at or near 6%, sports financial conditions that are looser than average, has Core PCE inflation at +3% and a pricing trend that has resided above the +2% target for the past five years, it is appropriate that the Fed has started raising the short-term policy rate in an attempt to put the economy back on a long-term sustainable path.

The era of low inflation and interest rates—best defined by insufficient aggregate demand and an abundance of supply—may be in the process of being temporarily replaced by one marked by scarce capital and goods, robust demand, inflation, and rising rates—at least in the intermediate term. In fits and starts over the past few years, that regime change has altered the trajectory for private equity, private credit, and other core financial and professional services that depend on medium- to long-term leverage at low interest rates.

Recently, the yield on the 30-year U.S. Treasury bond hit a multidecade high of 5.73%; in the U.K., the long bond stood over 6%, a level not observed since the mid-1990s; and comparable debt reached 5.6% in France, 3.9% in Germany, and 4.3% in Japan.

What is driving the increase?

The energy shock and the threat of rising inflation are important factors, but there is more to it than that. Specifically, governments are spending as if interest rates were still near zero and their economies were in crisis. While inflation expectations directly affect short-term money market rates and 2-year U.S. Treasury yields, their influence on longer-term interest rates becomes more muted further out on the yield curve. Long-term interest rates among the advanced economies have now moved beyond the 2022 pandemic-related inflation shock levels. In our view, the bond market is showing its concern over deficit spending. As a result, the long-awaited discussion on just how much debt is sustainable appears to be moving to the forefront of the global economic discussion.

All of this is evident in the term premium investors charge governments to compensate for the risk of holding long-dated paper. The current term premium for 10-year U.S. Treasury bonds (according to the Fed's ACM model of interest rate determination) is approximately 95 basis points, a new 12-year high. This near-1% reading marks a definitive end to the post-2008 regime. For much of the decade spanning 2014 to 2023, massive central bank interventions (via Quantitative Easing, or QE) compressed the ACM 10-year premium into deeply negative territory (at times reaching record lows of -1.37%). The Quantitative Tightening (QT) cycle and heightened duration anxiety have moved this metric back into positive territory.

This shift has, in turn, driven recent government Treasury strategies—such as the one in the U.S., where the fiscal authority has decided to pull back issuance at the long end of the curve in favor of the short end. That approach is itself creating new risks because of the way that the hedge fund community profits from highly-leveraged basis trade and swap spread arbitrage strategies that partially rely on Fed overnight repurchase agreement (repo) facility funding.

The recent rise of economic populism is also an issue that cannot be ignored. As we have discussed in the past, given the deleterious social and financial impacts of the decades-long dysfunctional and unbalanced global macroeconomic trade environment, the appeal of populism is understandable. Whether it comes from the right or the left of the political spectrum, it is an approach that typically seeks income redistribution by embracing expansionary fiscal policy (tax cuts, higher spending, or both) and protectionist measures, among other policies. Over time, these policies can lead to inflation, high deficits, or capital flight. If such policies go on long enough without a course correction, banking and currency crises tend to follow.

Global investors understand the end game of such policies. We are clearly nowhere near such a breaking point, nor are we yet approaching the return of the 1980s' "bond vigilantes," who, frustrated by loose fiscal policies, massive Federal budget deficits, and the persistent threat of double-digit inflation left over from the 1970s, forced bond prices down and pushed long-term interest rates dramatically higher, effectively hijacking control over economic tightening from the U.S. government. Currently, though, fixed income investors are expressing their concern.

History has shown that there is a time and place for deficit spending. Examples include the deficit spending on infrastructure, education, and healthcare that promoted economic activity during the Great Depression and after World War II. More recently, unfunded government outlays during the 2009 Financial Crisis and the 2020 Coronavirus pandemic were used to maintain household income and spending during those crises, laying the foundation for the economic recoveries that followed.

In both of those more recent episodes, monetary policy pushed interest rates near zero, making government and commercial spending effectively free in real (inflation-adjusted) terms once the economic recoveries and normal levels of inflation took hold. Interest rates are no longer near zero, however, and the increased cost of debt is adding to the original deficit spending. While the accumulation of debt was appropriate during the crises, the bond market is currently signaling that not taking constructive policy action to mitigate it may be a mistake.

Bottom Lines

We believe that our strategy during the current investment environment remains consistent with the investment strategy that we have followed in the past—essentially: to invest in high-quality businesses at the right valuations and hold them for as long as they remain high-quality businesses. In addition, we continue to believe that the long-term secular investment themes that we have previously identified remain intact.

Our investment process utilizes a combined top-down/bottom-up approach whereby, based upon our analysis of the components of global macroeconomic GDP, we identify a variety of investment themes, both secular and cyclical, that drive further fundamental analyses of individual businesses that meet our investment criteria. Currently, some of our investment themes include:

Rise of The Rest

Globalization and the development of the middle class in emerging markets is a long-term secular trend.

Disruptive Innovation

Companies that are disruptive innovators may be well positioned to outperform their peers in the current economic environment.

Regulation

Information Technology regulation, Healthcare reform, Infrastructure investment, and Climate Change policy are all currently areas of government focus, and the economic sectors within these areas may, therefore, be subject to challenges or opportunities based upon how successful the government is in implementing its programs.

Continued De-leveraging

De-leveraging and the shrinking of private and public balance sheets will be a multi-year process that will restrain global macroeconomic growth.

The Great Unwind

The eventual "normalization" of monetary policy may result in unforeseen and unintended consequences.

China Rebalancing

The rebalancing of China's economy from investment- to consumer-driven has significant global macroeconomic ramifications.

Supply and Demand

Global macroeconomic growth remains anemic due to a surfeit of supply and a dearth of demand.

Demographics

Demographically, the aging of the populations of the developed, and some developing, economies will have important implications for future demand growth and entitlement costs.

As you know, we do not predict, nor does your *Windward* portfolio own, "the market." Instead, we seek to mitigate market risk and generate excess returns by making long-term investments in individual businesses with the following underlying fundamental characteristics:

Quality

Dominant, financially strong, leading companies with established managements, high incremental returns on invested capital, and business models with competitive advantages

Growth

Companies with predictable and sustainable above-average growth in revenue, earnings, and free cash flow

Value

Companies that are undervalued on either an absolute or relative basis, based upon our projections of future cash flow and earnings

Our goal, as always, is to identify those companies and invest in them for your *Windward* portfolio. Our risk averse approach to managing your investments causes us to take a more measured and unemotional view of extremes in bullish or bearish sentiment and find ways to potentially outperform the market with less volatility by focusing on specific companies' fundamentals.

Windward's portfolios of individual businesses, with their own company-specific fundamental dynamics, are continuing to thrive and prosper, in our opinion. In the short term, this fact may be obscured by "market action"—which results in highly-correlated security price movements during periods of increased volatility—and/or the negative influences of ETFs, asset allocators, speculators, and algorithmic traders—whose focus is on baskets of securities or on stock symbols, not on underlying business model fundamentals. However, financial history has shown, time and again, that, over the long term, investors are often rewarded by being owners of these types of companies.

We believe that the "indices" will become less relevant as time goes on and that successful wealth creation and capital preservation in the years to come will become increasingly dependent upon the identification and ownership of those businesses that, although possibly impacted by exogenous events in the short run, remain relatively immune to these global macroeconomic issues over the long run due to their own underlying growth dynamics.

We remain exceedingly optimistic on the prospects

for the individual companies that we own in *Windward* portfolios and encourage you to contact us should you have any questions or concerns.

Sources:

Bank for International Settlements
Bloomberg
Congressional Budget Office
Council of Economic Advisers
FactSet
Federal Reserve Banks of Atlanta, New York, Philadelphia, San Francisco, and St. Louis
FINRA
International Energy Agency
International Monetary Fund
Organisation for Economic Co-operation and Development
Reuters
S&P Global
The World Bank
U.S. Bureau of Economic Analysis
U.S. Bureau of Labor Statistics
U.S. Congress
U.S. Department of the Treasury
U.S. Federal Reserve
U.S. White House

* There is no guarantee that the investment objectives presented in this newsletter will be achieved. Moreover, the past performance is not a guarantee or indicator of future results.

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Certain information contained herein constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "project," "estimate," "intend," "continue," or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events, results or actual performance may differ materially from those reflected or contemplated in such forward-looking statements. Nothing contained herein may be relied upon as a guarantee, promise, assurance or a representation as to the future.

HAS YOUR FINANCIAL CONDITION CHANGED?

Portfolio decisions are based on an individual's income requirements, tax bracket, time to retirement, risk tolerance, and other characteristics. If your financial condition has changed, such as your investment objectives, risk tolerance, time horizon, or employment status, please notify us in writing immediately, as this may impact how we manage your account. Additionally, if you would like to place reasonable restrictions on the way we manage your account, or revise any existing restriction, please notify us in writing immediately. We strive to prepare a portfolio that meets each investor's objectives, and the more information we have, the better the job we can do. If you have any questions regarding your portfolio, your asset allocation, or any investment within your portfolio, please let us know.

THE FUTURE IS NOW

As you may know, we post a weekly commentary on our website most Friday afternoons. We only mail some of these comments out when markets are particularly unsettled. Please be aware that these notes will continue to be available on-line at www.windwardcapital.com under "Commentary."

We encourage you to log into your account at your custodian for real-time, updated account information. If you need assistance, please call our Operations Department at (310) 893-3000.

We have included a copy of our Form ADV Part 2 and Form CRS with this report. If you have any questions, please email Jeremy Johnson at : johnson@windwardcapital.com, or call him at our main number: (310) 893-3000.

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