Belle Haven INVESTMENTS

Q3 2025 Newsletter

Market and Credit Insights from Belle Haven's Investment Team

Before & After the Cut

Market Insights

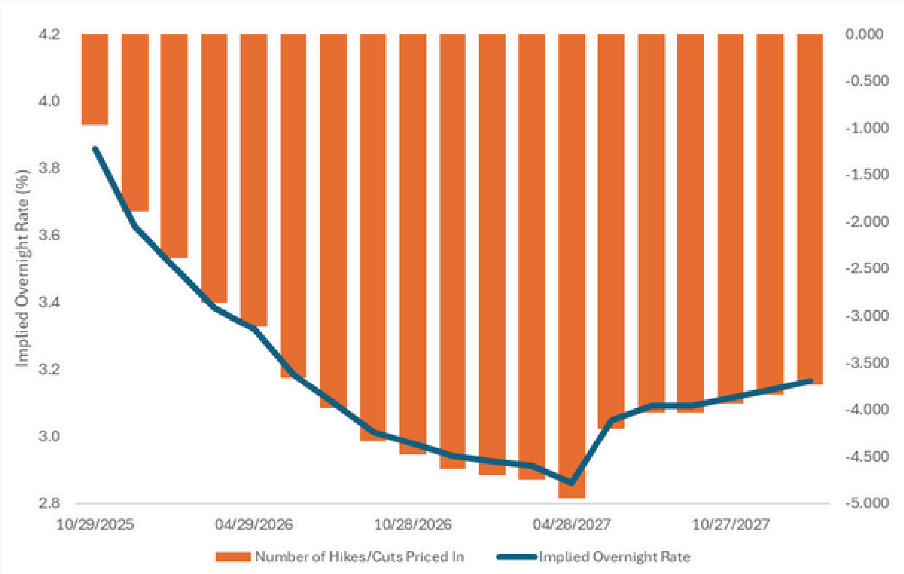
Late summer was defined by a singular market narrative: the growing expectation that the Federal Reserve would soon begin easing policy. That shift gained momentum after July's employment report revealed slower-than-expected job growth and downward revisions to prior months. By the time Chairman Powell addressed markets at Jackson Hole in August, his acknowledgment of a softening labor market and moderating inflation reinforced the market's dovish expectations.

What's inside our latest issue:

Ahead of the September FOMC meeting, August payroll data confirmed this trend. Markets quickly priced in a 25-basis-point rate cut at each of the remaining three meetings in 2025, with some forecasters speculating on a larger initial move. When the Fed delivered a 25-basis-point cut in September, rates briefly rallied—until Powell described the decision as a "risk management" step rather than the start of a full easing cycle. That clarification prompted a reversal, leaving investors focused once again on incoming data to determine the Fed's next move.

Economic indicators released after the meeting pointed to resilience. Both GDP and jobless claims came in stronger than expected, tempering expectations for aggressive easing. As of quarter-end, markets were fully pricing in another 25-basis-point cut at the October meeting, with roughly three-quarters odds of a similar move in December. The path forward appears increasingly data-dependent, emphasizing flexibility over precommitment.

Implied Overnight Rate & Number of Hikes/Cuts



Source: Bloomberg, 9/30/2025

The Fed After Powell

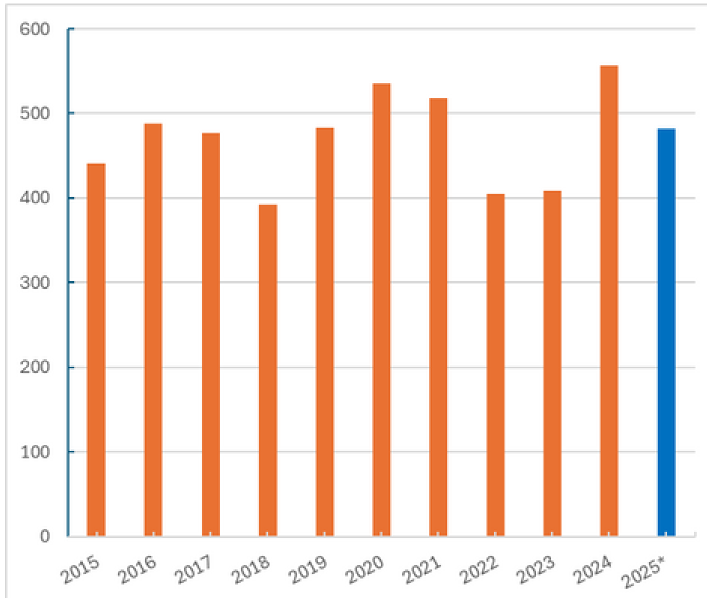
Market attention has also turned toward the longer-term trajectory of Fed leadership. Chairman Powell's term expires in May 2026, and speculation around potential successors is building. Recent appointee Stephen Miran—who voted for a 50-basis-point cut in September—has emerged as a leading figure in the conversation, signaling an openness to more accommodative policy. The contrasting stances among governors, including Christopher Waller and Michelle Bowman, highlight the ideological diversity within the current FOMC. Depending on future appointments, the post-Powell era could bring a measurable tilt toward a more pro-growth, easing-oriented framework.

A Constructive Rebound for Fixed Income

Municipal bonds staged a notable recovery in the third quarter, resulting in significant positive returns. The Bloomberg Municipal Bond Index returned 2.64%, marking the year's first positive quarterly performance. Earlier weakness had been driven more by technical pressures—persistent mutual fund outflows and elevated issuance—than by any deterioration in credit quality. Sentiment turned decisively in August as expectations of Fed cuts supported inflows and stabilized performance across the curve.

The municipal yield curve steepened modestly, particularly in the 10–20-year range, where investors can now access tax-exempt yields north of 4%. The spread between 10- and 20-year maturities has widened to roughly 106 basis points, providing an attractive entry point for investors seeking incremental yield through duration extension.

Annual Municipal Issuance



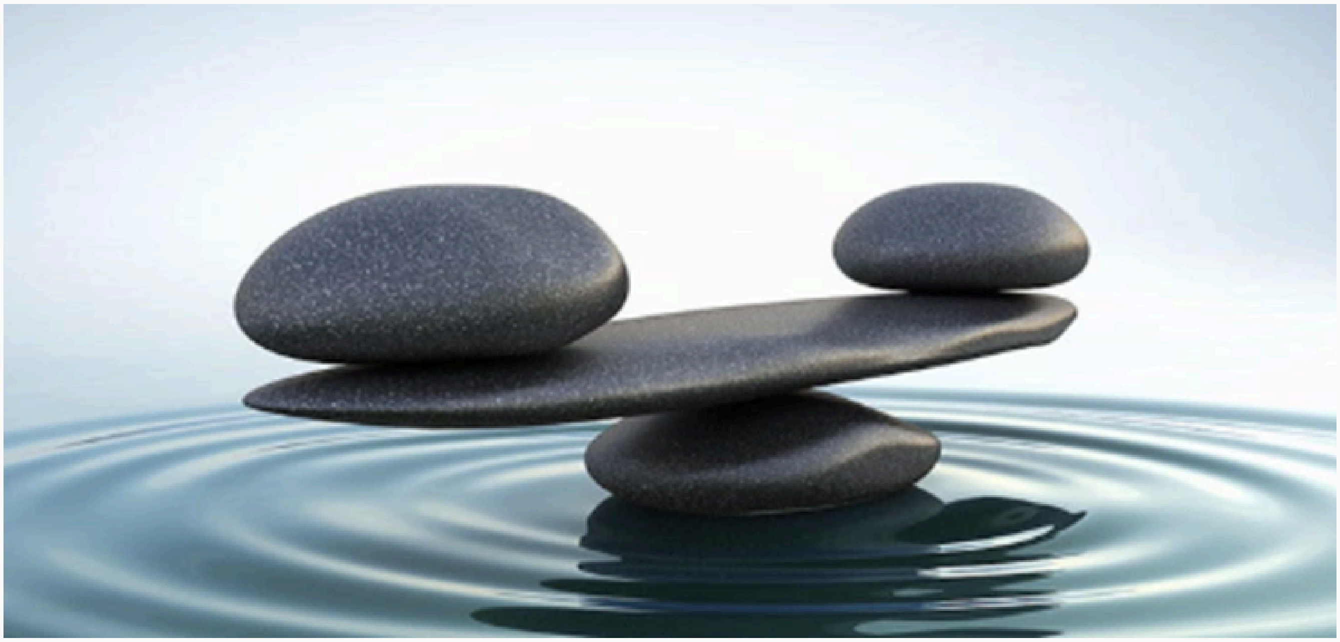
*Note: Values in blue reflect issuance as of 9/30/2025
Source: Bloomberg, 9/30/2025

Looking ahead, two technical headwinds bear watching. The first is the ongoing federal government shutdown, which—while unlikely to pose material credit risk—could weigh on sentiment. The second is record issuance. Year-to-date supply has exceeded $460 billion, with projections of $100–$150 billion more in Q4. Should that materialize, 2025 would mark the second consecutive year of record-breaking issuance. While heavy supply could pressure near-term pricing, it also offers selective opportunities for investors to add yield and enhance diversification.

In both the tax-exempt and taxable municipal markets, we continue to see value in intermediate maturities, where curve steepness enhances the potential for both income and performance. Reducing reinvestment risk remains prudent for investors comfortable managing volatility, as longer positions currently offer superior risk-adjusted returns relative to the front end. By contrast, shorter maturities continue to offer limited incremental yield.

In the corporate bond market, spreads remain tight—investment-grade option-adjusted spreads hover near 75 basis points, and AA spreads around 40 basis points. However, dispersion is increasing at the lower end of the credit spectrum. Investors have rotated toward higher-quality assets, supporting relative outperformance in high-grade credit. In this environment, incremental yield is not adequately compensating for downgrade risk, reinforcing a cautious stance on corporate exposure.

Taxable municipal bonds, by comparison, continue to offer compelling value. Strong underlying credit quality and attractive spreads relative to corporates make the sector a meaningful alternative for investors seeking both income and capital stability.



Headline Risks and Fundamentals

CREDIT INSIGHTS

Federal Government Shutdown: Limited Municipal Exposure

Historical precedent—most notably the 35-day shutdown in 2018—suggests minimal direct credit impact to municipal issuers. While short-term disruptions may occur in localities with high concentrations of federal workers or defense contracts, broad municipal finances remain insulated. Belle Haven portfolios do not hold credits lacking structural protections against prolonged federal funding lapses, and we continue to monitor at-risk issuers for early signs of strain.

Federal Funding Reductions: Gradual Implementation

The majority of spending reductions under the One Big Beautiful Bill Act (OBBBA) are deferred until 2027, allowing state and local governments ample time to adjust budgets and revenue structures. Historically, municipalities have managed similar fiscal transitions through a combination of revenue increases, spending adjustments, and reserve utilization. We do not expect elevated default activity tied to these changes, and the extended timeline supports measured fiscal adaptation.

Debt Dynamics: Federal vs. State and Local

While the national debt continues to make headlines, state and local governments remain comparatively disciplined. Statutory debt limits, balanced budget requirements, and voter approval processes have constrained borrowing. As a share of GDP, state and local debt has declined from 17.4% in 2015 to just 11.4% in early 2025—a trend that provides capacity and flexibility for future capital needs.

State & Local Debt as a % of GDP (2025 Q2 - 2025 Q1)

Source: Federal Reserve Economic Data (FRED) State and Local Governments Debt / United States Gross Domestic Product Quarterly as of December 2024

Outlook

Municipal credit quality remains sound, supported by prudent fiscal management and conservative borrowing practices. While political and fiscal uncertainty can drive short-term volatility, we view the market's underlying fundamentals as durable. Heading into 2026's budget season, our credit team is focused on monitoring reserve usage, structural balance, and demographic trends that may shape long-term fiscal trajectories.

In this environment, disciplined active management remains essential—balancing technical entry points, yield curve dynamics, and credit selectivity to optimize tax-exempt income and preserve capital.

Portfolio Management

J. Matthew Dalton
CEO & CIO
Partner

Matt Thomas
Portfolio Manager
Partner

Max Christiana
Portfolio Manager
Partner

Lincoln James
Portfolio Manager

Credit Research

Dora Lee
Director of Research
Partner

James Lyman
Senior Vice President,
Credit Research

Ryan Ciavarelli
Senior Vice President,
Credit Research

Michael Luong
Vice President,
Credit Research

Duwayne Walker
Vice President,
Credit Research

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Contact

914-816-4633

service@bellehaven.com

www.bellehaven.com

Belle Haven Investments

800 Westchester Ave. Suite N607

Rye Brook, New York 10573