DECEMBER 2025

INVESTMENT UPDATE

This will be the final *Investment Update* of 2025, and incidentally, this will be my last chance to contribute to a publication that I've had the pleasure to oversee for more than 25 years. To the extent you find these updates to be of value, you will be happy to know that they will continue after my retirement. Best of all, the quality can only go up from here!

By my count, this will be the 205th edition of what has been, over the years, both a pleasure and a curse for me to write. A pleasure, since it's been an effective way to talk about broad topics that we think are important to bond investors. We realized just a few months after we started Agincourt in 1999 that frequent and timely communications with our clients were essential, not just for "building our brand," but because we believed it was our job to provide thought-provoking, educational—and perhaps even entertaining—information to our clients. Quarterly portfolio review/outlook letters alone wouldn't cut it—they were too infrequent and dry for that purpose. We needed something a little less formal, a little more open-ended and freewheeling.

And yes, it's been a curse, since it's often been a real pain in the *tuchus*, if I'm being honest. Just coming up with interesting topics to write about has been a real challenge at times. Putting these updates together over the years has forced me to dig deep, often looking outside the bond market for ideas and inspiration. Tackling broad subjects like global demographics, the history of the Federal Reserve, or the impact of the non-banking mortgage lending industry requires research; you can't write about something you have only a passing familiarity with.

Twenty-five years is a long time—one of our first *Investment Updates* opened with a discussion of "Fed Chairman Alan Greenspan" and made references to bonds issued by Finova, Laidlaw, JC Penney, and Xerox—all companies that either no longer exist, or have gone through bankruptcy this century. Back in mid-2000, the dot-com boom was turning into a bust, Patrick Mahomes was in preschool, nobody had ever heard of an iPhone or a Facebook, and AOL was where most of us got email (if you even had email). "AI" was just the name of a movie Steven Spielberg was working on.

We've also seen big structural changes in the US bond market since 2000, not just in the size of the market, but also in its components. Using the Bloomberg (formerly "Lehman," another casualty) Aggregate Index as a proxy, the high-grade US bond market today has a value of $31 trillion, compared to $5.3 trillion at the start of 2000 ($10.2 trillion in today's dollars). US Treasury securities currently make up 46% of the Aggregate Index, compared to just 32% in January of 2000. Corporate bonds also comprise a larger share of the Aggregate Index today (24% vs. 17%), with the other major components, US agency mortgage-backed securities (MBS) and US agency debentures shrinking from a combined 43% to just 25% of the Index.

Looking back, it's easy to tie the changes in the US bond market to what was happening at the macro level. For instance, in 2000, the US was running budget surpluses, meaning that US Treasury bond issuance was shrinking; the opposite is true today, as the US government has been running huge budget deficits almost every year since 2003. Those deficits have been due to both shrinking revenues (as a percent of GDP) and increased spending by the government, with two major events—the Global Financial Crisis (GFC) and COVID—requiring emergency spending to prop up the US economy. The GFC was caused, to a large extent, by the collapse of the over-levered US housing market. When home prices collapsed, so did the value of MBS, sending the US mortgage agencies (GNMA, FNMA and FHLMC) into receivership, and shrinking MBS' share of the bond market.

The GFC was no ordinary recession; its impact was so wide and deep that it forced institutional changes that are still being felt. Bank regulation and consumer protection efforts, while necessary to re-establish credibility and security for consumers and taxpayers, forced banks to raise capital to new, higher levels, and to modify (and in some cases, completely curtail) certain lending practices and lines of businesses. In Europe, it took more than a decade to re-capitalize the banking system, which caused a prolonged recession and below-zero lending rates. In the US, new regulations led to explosive growth in the lightly-regulated US nonbank and private lending channels, a potential future weak link in the banking system.

The GFC also forced the Federal Reserve to pull out new tools to counteract the damage from the deep hole the US economy found itself in, most notably, in the use of quantitative easing (QE). In 2009, after having lowered its overnight lending rate to zero and with the US economy flat-lining, the Fed began buying Treasury and agency bonds in the open market, reducing the supply of tradeable government bonds and lowering interest rates across the full maturity range. This has led, over the years, to a much larger Fed balance sheet, and a controversial expansion of influence over not just the banking system, but on

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the broader global capital markets.

Like the GFC, the COVID crisis threatened the US economy with economic ruin, and the Fed stepped in once again, dropping the overnight Fed funds rate to zero and announcing in March of 2020 that it would resume buying not just US government bonds, but corporate bonds, too, for the first time. The markets calmed, buoyed by both the Fed's commitment to supporting the capital markets, as well as announced federal emergency relief funds that soon flowed to households and businesses. Once again, the Fed was criticized for overreaching (if not for outright manipulation of the bond market) from yet another large-scale program of government bond purchases. A footnote: the bond market recovered so quickly the Fed never found the need to buy corporate bonds as part of its QE program.

It's pretty clear that US fiscal and monetary policies have taken on more expansive roles over the past two and a half decades; that's at least partially attributable to the fact that we've had two "once in a lifetime" global crises over the period. But it also reflects the reality that policymakers have become far more comfortable intervening in the private affairs of businesses. Looking back, there's room for criticism about the loss of "moral hazard"—the idea that those who take a high level of risk should suffer downturns as equally as they enjoy profits when the markets are in their favor. During the GFC, large banks (and their shareholders) were mostly spared the axe, despite being functionally bankrupt due to inadequate capital to cover mounting losses, a result of poor underwriting and risk management. GM and Chrysler (among others) were bailed out as well, as both were deemed too important to the overall US economy to lose. Likewise, during COVID, hundreds of billions of dollars were funneled to businesses, large and small, in order to keep the economy afloat.

It's easy to criticize these moves from a pure capitalistic standpoint, and, to be clear, we are strong believers in the principles of capitalism. At the same time, policymakers do the best they can with limited information. Who's to say, even today with the full benefit of hindsight, how quickly and to what extent the US economy would have recovered from COVID without the emergency measures from the Fed and, more broadly, the US government? It's likely that an excess of emergency funds led to higher inflation post-COVID, but would failing to provide those funds have put the US in a deeper economic hole that would have added years to the recovery time? Hopefully, we will learn from these experiences, and future crises will be counteracted with policies more finely-tuned to get the support where it's most needed.

We can't talk about the major changes impacting the bond market over the last couple of decades without mentioning technology. Here at Agincourt, technology has transformed the activities of every one of our employees, from portfolio managers and analysts to our compliance team. Twenty-five years ago, we were still picking up the phone to execute most of our bond trades; today, electronic trading platforms and electronic communications have made telephones redundant on our trading desk. Technology has allowed us to build a portfolio management system that ensures compliance by screening possible investments before trades are lined up. Our portfolio management team is continuously refining our analytics systems, adding accuracy and granularity to the day-to-day analysis and management of our clients' portfolios. Agincourt's operations team is at least three times as efficient today as it was twenty-five years ago, based on the volume of work this small team generates. The firm has made expensive, yet vital, investments in technology, with a particular focus on information security. And, yes, we're already using AI tools to increase productivity further (we'll have more on AI's impact on the bond market in future *Investment Updates*).

If you'll allow me, I'd like to say a few more words about our team here at Agincourt. I've had the opportunity—and this goes way back, 40+ years—to work with and see how various investment management firms go about their business. I've met hundreds of people along the way, some of whom have shared their experiences, and compared those to my own. I've seen how other firms talk about themselves, their processes, their philosophies. I've watched how the representatives of those other investment shops talked to clients when things were going well and when they weren't. And, as Yogi Berra famously said, "You can observe a lot just by watching!"

What I observed, and what I came to understand, was that people who operated without morals, who weren't honest with themselves or their clients, who overpromised and under-delivered—those people and their organizations eventually failed. The investment management business is built on trust. When clients hire Agincourt, they do so with the belief that we will live up to the client's expectations, despite the fact that they don't really know us very well. That's a leap of faith that we take very, very seriously.

I'm extremely proud of the team we've assembled at Agincourt. It's no exaggeration to say that our organization is the strongest, from top to bottom, that it's ever been. We have added to both our portfolio management and structured products teams in the past 18 months and will continue to add talented people to our organization as we grow. I will put our portfolio managers and analysts up against any others in our industry; they have all the experience, skills, and discipline to continue to generate excellent results for our clients. Our team operates with the highest ethical standards. We may be considered a "boutique" firm compared to the giants of our industry, but with $10 billion under management (a high-water mark for us), we are prepared to compete with anyone.

Finally, I want to say thank you to our clients and those who assist our clients. I am truly grateful.

Pat Kelly