



The ADVISOR

Focus on Community Banking Issues

Fourth Quarter 2025

ECONOMIC ENVIRONMENT

A Waiting Game

The U.S. economy continues to expand at a measured but durable pace, demonstrating resilience in the face of policy uncertainty, elevated tariffs, and the prolonged government shutdown. Growth has held firmer than expected through the first ten months of the year, supported by steady consumer spending and still-healthy business investment. Monetary policy remains in a phase of adjustment. The Fed appears intent on proceeding with another 25 basis point cut at the October meeting, as policymakers are attempting to balance a softer labor market with inflation that while firm, appears lower than feared earlier in the year.

Rising Inflation is Not Broad-Based

Inflation was slightly higher in September, but came in below expectations, giving the Fed more confidence to follow through with its planned rate cuts. The key takeaway is that price pressures remain concentrated in tariff-sensitive goods, not across the broader economy. Apparel, furniture, and sporting goods each saw noticeable price jumps, but easing shelter costs and weaker used-vehicle prices helped offset those increases. So, can we expect much more of a tariff-related jump in prices? To assess this, we can look at the PPI as a leading indicator, which suggests that roughly 70% of the higher tariff costs have been passed along through the value chain. However, these cost increases have come mostly to wholesalers, retailers,

and other manufacturers, rather than to consumers. This dynamic has kept consumer inflation relatively stable, though it has begun to compress margins upstream.

Encouragingly, manufacturers have been disciplined in this inflation cycle, absorbing more of the tariff burden and utilizing cost-mitigation strategies such as bonded warehouses and Free Trade Zones to delay tariff payments. These measures have offset a portion of total tariff costs and allowed firms to preserve competitiveness. While inflation remains frustratingly above the Fed's long-term 2% goal, the

Features

Economic Environment:

- US Economy is Stronger than Job Market Indicates

Fixed Income Strategy:

- 2025 Rate Path Looks Clear, 2026 Less so

Equity Strategy:

- Will AI Driven Momentum Continue?

ALM Strategy:

- How Will Multiple Fed Cuts Impact Strategy?

EPG RATE OUTLOOK

October 2025

MARKET RATE	Actual (%) 9/30/2025	Projected (%) 9/30/2026	Yr1 Δ	Projected (%) 9/30/2027	Yr2 Δ
FedFunds	4.25	3.50	-0.75	3.50	0.00
Prime	7.25	6.50	-0.75	6.50	0.00
3mthTsy	3.93	3.60	-0.33	3.70	0.10
6mthTsy	3.84	3.70	-0.14	3.80	0.10
1yrTsy	3.61	3.75	0.14	3.90	0.15
2yrTsy	3.61	3.80	0.19	3.95	0.15
3yrTsy	3.62	3.80	0.18	4.00	0.20
5yrTsy	3.74	3.85	0.11	4.05	0.20
10yrTsy	4.15	3.90	-0.25	4.15	0.25
30yrTsy	4.73	4.15	-0.58	4.40	0.25

RATE OUTLOOK DESCRIPTION:

This represents EPG's current view of interest rates. Depending on the actual timing of the ALM meeting, the outlook may be altered and/or updated. For the most accurate current rate outlook, please call EPG, Inc. at (781) 235-2666.

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recent data suggests that price growth may not accelerate much higher. Therefore, the backdrop gives the central bank enough flexibility to continue easing policy while maintaining credibility on its dual mandate.

Labor Market: Soft Enough to Support Easing

Labor market conditions continue to soften, but in our opinion are not collapsing. Private-sector data shows hiring has slowed, with just 22,000 jobs added in August (the last month with official figures available). Surveys from payroll processors and financial institutions indicate hiring remained subdued in September, although layoffs have not meaningfully

accelerated. As such, the slowdown in job creation, rather than widespread job loss, has become the largest risk to economic growth.

The Fed’s latest projections reflect this shift; the unemployment rate is now expected to stabilize around 4.4–4.5% over the next two years, slightly lower than forecast in June. Wage gains have eased from their 2022–2023 highs but continue to outpace headline inflation, suggesting consumer purchasing power remains intact. Taken together, the labor market’s slow normalization supports the Fed’s soft-landing thesis. Growth is no longer overheating, but there are few signs of a broader downturn.

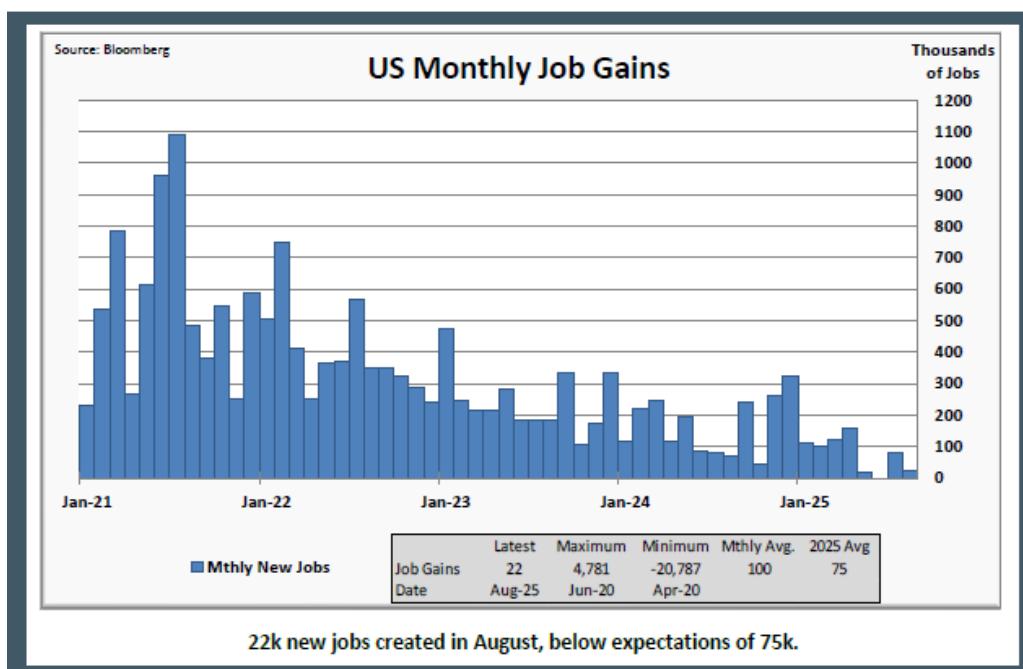
Consumer Spending & Economic Growth: Rotation, Not Retraction

Household spending remains a stabilizing force in the economy, even as sentiment has slipped.

The University of Michigan’s consumer sentiment index fell to 53.6 in October from 55.1 in September, reflecting frustration with persistent price levels and policy gridlock. Yet, consumers continue to spend, particularly on services, travel, and leisure; the level of consumption has been upheld by easing borrowing costs and a still-wide spread between wage growth and inflation. This was reflected in second-quarter GDP, which was revised up to a 3.8% annualized gain, reinforcing that the economy retains underlying momentum even as it transitions toward slower, more sustainable growth in the back half of the year.

Wage Growth Continues to Track Above Inflation, Fueling Consumer Spending

Understandably, spending patterns show a rotation away



Source: Bloomberg

ECONOMIC ENVIRONMENT



from goods most exposed to tariffs and toward service categories more insulated from trade dynamics. Vehicle and housing demand have shown tentative improvement amid lower mortgage rates, while retailers are increasingly relying on promotions and inventory management to maintain sales volume. These trends point to a rebalanced, not retreating, consumer sector heading into 2026. Even if consumer spending transitions to a slower pace of growth, the ongoing wave of AI-driven business investment provides an important counterbalance in our opinion. By increasing productivity and enabling companies to boost output with a leaner workforce, these efficiency gains may help extend this period of economic expansion even if hiring cools further.

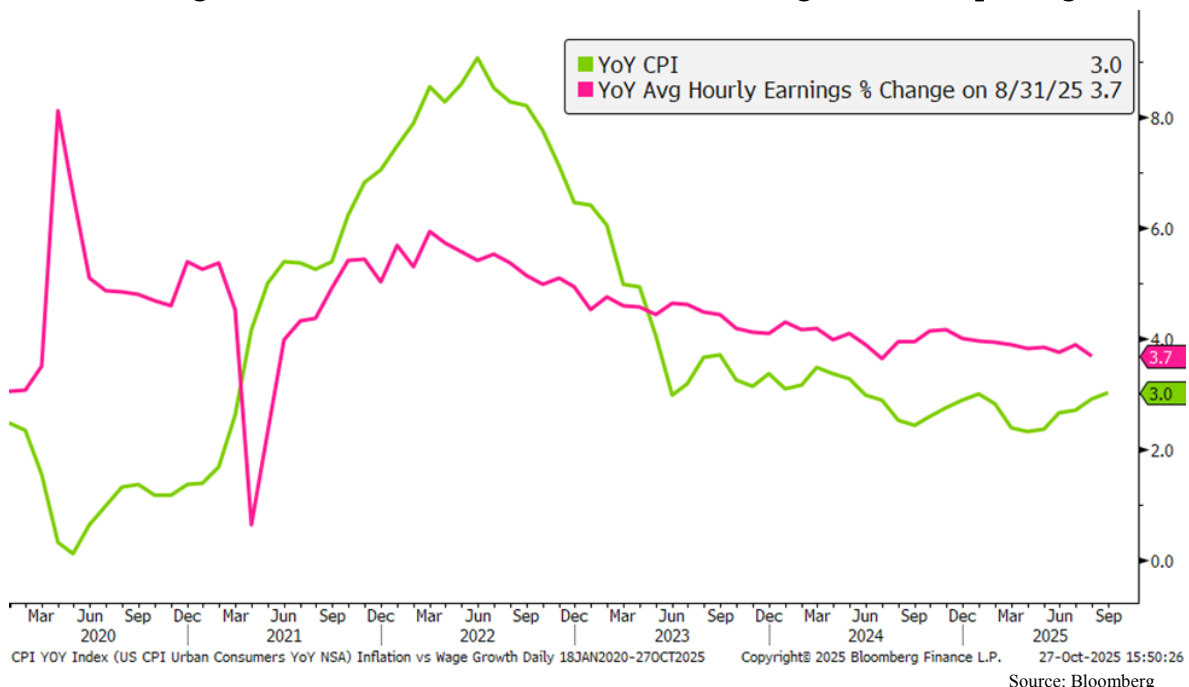
EPG Rate Outlook: Ready or Not, Cuts are Coming

The Fed remains committed to its gradual easing plan, even as divisions among policymakers widen. The consensus favors two additional cuts this year, but the dispersion of views on the 2026–2027 path highlights uncertainty around inflation persistence, potential leadership changes, and the long-term equilibrium rate.

While the shutdown has put labor market data on hold, Fed Chair Powell’s recent comments suggest that the outlook for employment and inflation has not materially changed since September, signaling comfort with the gradual easing path already outlined. Given this backdrop, we expect 25-basis point rate cuts in October and December, with a third cut in mid-2026 to achieve a 3.50%

terminal rate. We also expect the yield curve to maintain a normalized shape over the long term, driven by long-end resistance and diminishing demand for duration. Currently, markets appear to be already pricing in this policy mix of near-term easing paired with sticky long-term inflationary risk. For now, the combination of slower growth, modest inflation, and still-anchored expectations keeps the policy trajectory aligned with a soft-landing scenario. ♦

Wage Growth Continues to Track Inflation, Fueling Consumer Spending





FIXED INCOME STRATEGY

FIXED INCOME STRATEGY

Short Term Interest Rate Path Set for 2025: What About 2026 and Long-Term Rates?

The current path for rate cuts looks clear through 2025, but after that much less so. With a weakening employment picture, Fed officials revised their forecast in September, now projecting two more cuts in 2025 where there was previously just one. Full year 2026 looks to bring significant changes among policymakers, with a wide range of opinions about the future path for interest rates. In the short term, we would categorize the biggest risk to the U.S. economy as a deceleration in job growth, which was the culprit behind policy makers modification to their forecast in September. It was a little surprising to us that they added back an additional rate cut in 2025, which had previously

been removed during the June meeting and pushed out until 2027. To add more confusion, the government shutdown has put the September Nonfarm Payroll release on hold for the time being, with no future date set until the shutdown has ended. The Investment Committee views the slowdown in private sector payrolls as sufficient support to justify a near-term cut amid an already softening labor market. As a result, officials are expected to follow through with a 25 basis point rate cut at the October meeting.

We may have more policy consistency for the remainder of this year, but the dispersion of opinions is hard to ignore. There is one FOMC voter envisioning only one more rate cut by year end, six see no change in rates, nine are expecting 50 basis points of additional cuts, and Stephen Moran, the newest FOMC member, believes the Fed is behind the curve and suggests an additional 125 basis points of easing by the end of the year. The Investment Committee views this as a remarkably wide array of opinions,

considering we are only talking about a time frame over the next 8 or so weeks. However, all members were in full support of the September policy change. On the economic front, recent data continues to surprise to the upside. In September, second quarter GDP was revised upward from 3.3% to a 3.8% annualized gain. Meanwhile, retail sales have outpaced expectations over the last quarter, suggesting that U.S. consumers remain resilient, even with signs of a softening labor market.

As a result of above target inflation, policy makers appear cautious heading into 2026, only calling for one more 25 basis point reduction in the fed funds rate to a range of (3.25%-3.50%). We find this surprising as President Trump will likely be appointing a new Fed chair in May, a seat that Christopher Waller and Michelle Bowman (both nominated by Trump) would likely be very interested in taking if nominated. All suspicion seems to indicate that the new Fed chair will have a dovish tilt in their economic view.

Yield Curve 12/31/2024 - 9/30/2025



Source: Bloomberg

Yield Curve Changes Year to Date

Term	12/31/2024	9/30/2025	Change
2 Year	4.24	3.61	-0.63
3 Year	4.27	3.62	-0.65
5 Year	4.38	3.74	-0.64
7 Year	4.48	3.93	-0.55
10 Year	4.57	4.15	-0.42
20 Year	4.86	4.70	-0.16
30 Year	4.78	4.73	-0.05

FIXED INCOME STRATEGY

We would like to believe that the Fed's independence will prevail and policy decisions will have a stronger emphasis on the dual mandate rather than political pressure, although today's independence appears increasingly fragile. Despite that, most economists forecast that inflation will remain above the target rate for the foreseeable future, even as the easing cycle continues. Alternatively, Fed officials could consider raising the bar on long term inflation, which seems unlikely as they continue to focus on the longer-term target of 2.0%. This suggests the current easing cycle could be relatively short lived if elevated inflation persists, and that's before considering the potential impact of new tariffs, which could put further pressure on consumer prices and the broader economy.

In the short term, dovish policymakers may dominate the narrative, but inflation and the long end of the yield curve appear to be sending markets a different signal. Normally, policymakers are hesitant to cut rates with elevated inflation, which does not seem to be the case this time. Interestingly, longer term Treasuries have not responded as expected to signs of weakness in the labor market. Instead, the lack of demand for longer duration Treasuries, combined with persistent inflation, has steepened out the yield curve with longer term Treasuries and mortgage rates higher than investors initially

anticipated. If inflation remains sticky, and as long as the labor market doesn't completely collapse, it is possible that longer term interest rates are already pricing in future policy action. Under that scenario, current policy would likely fall further behind the curve, making it possible for a quick reversal in policy, potentially as soon as 2027, to contain pricing pressure.

Yield Curve Steepening Helps Enhance Margins with Long End Resistance:

The front end of the yield curve continues to build in an easing bias, while the longer end remains more resistant to breaking the trading range. Longer dated Treasuries remain on the higher side of historical yield levels, with the 10 Year Treasury hovering near 4.0%. The Investment Committee believes the yield curve has been volatile for both fundamental and technical reasons. First, inflation remains above the longer-term target rate of 2.0%, and longer term Treasuries have been hesitant to react as aggressively as shorter term maturities. Although consumer prices remained in check during the third quarter, producer prices expanded and it is likely this will impact the consumer during the fourth quarter. Demand has also diminished on the longer end of the yield curve. Foreign buyers and U.S. pension funds have moderated their appetite for longer duration, forcing dealer balance sheets to absorb the



excess supply. As a result, the 10-year and longer duration part of the yield curve is waiting for more confidence in economic conditions regarding tariffs, inflation, and employment before traders reprice to a new range.

Even with market uncertainty this year, the additional yield associated with investing in both corporate bonds and mortgages remain in a tight range. Corporate and Municipal bond spreads continue to remain firm, suggesting limited opportunities to add accretive credit-related products to existing balance sheets. That said, we have seen opportunities on tax exempt housing bonds that offer accretive book yields. Although call risk can have disadvantages, the additional spread in fixed / floating rate MBS and Callable Agencies offer attractive risk adjusted yields above the SOFR rate and traditional bullet like Treasuries. ♦



EQUITY STRATEGY

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Momentum continues?

While many investors are looking at the current equity markets with “guarded enthusiasm,” the underlying momentum contributing to the lift in equity valuations is now being attributed to companies benefiting from AI, not solely technology companies operating in the artificial intelligence space. AI is fundamentally changing almost all elements of how the economy operates, and how corporations are building business models and structures for the future. Importantly though, the current momentum in equity markets has expanded to additional industries

and sectors based on other themes such as Fed rate cuts and the potential positive impact on spending, outlook, and profitability. A yield curve representing future lower funding costs has contributed to the recent momentum that has been seen, for example, in the Financials sector.

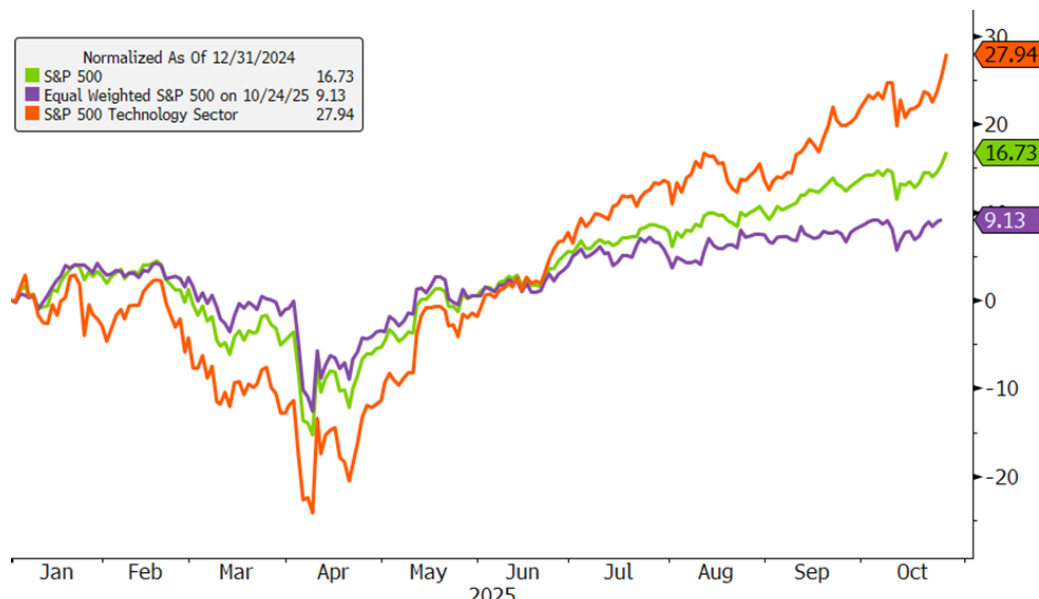
Does momentum become a bubble?

Comparisons between the current AI-fueled equity valuations and past “bubbles” such as the dot.com bubble, are becoming increasingly common among investors, with some expressing concern that AI-linked companies may meet a similar fate. However, there are some differences which are useful to identify and thus place current valuations in proper perspective. This is not to say that valuations are not elevated at a company specific level,

but a wholesale view of AI companies being overvalued based on momentum is questionable. Record cashflows, strong profitability, and massive cash “war chests” distinguish this period of AI driven momentum from other unsupportable periods that were characterized as bubbles.

One lesson perhaps learned from historic periods of speculative frenzy is that during those periods of unsustainable enthusiasm, capital often poured into equity alternatives with little regard for actual business models, profitability, or forward-looking fundamental analysis. This seems to be quite different than today’s equity market sentiment. Investors are not buying with abandon, but instead are demonstrating a more cautious sentiment, supported by the view that there are as many individual investor bears as bulls. For example, the American

YTD Performance: S&P 500, Technology Sector, and Equal-Weighted S&P



SPX Index (S&P 500 INDEX) Indices Daily 31DEC2024-27OCT2025 Copyright© 2025 Bloomberg Finance L.P. 27-Oct-2025 15:49:47 Source: Bloomberg



Association of Individual Investor survey shows more bears than bulls, with its reading slipping below zero.

Will rate cuts keep the momentum going?

What was an AI-based momentum story over the last several years has now spread out to capture more broad-based equity investing alternatives. Companies that are or will show the value which AI, monetized through increased profitability and retaining leadership positions in their industries and the economy in general, are now joining AI specific technology names on the upward momentum track. An important driver for this expanded momentum is the expectation of continued Federal Reserve action of cutting short term interest rates. Rate cuts are a critical element for continued equity market positive sentiment and momentum. Importantly, the degree to which rates are cut and the speed of such cuts will signal to equity investors whether this is a fine tuning of an economy with the goal of minimizing probability of economic slowdown, or a reaction to an economy that is already contracting, and thus likely to negatively impact related consumer spending and corporate earnings.

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What can stall momentum?

Ultimately, earnings matter, and regardless of momentum and cash flow into equity markets, the ability of a company to show industry leadership during periods of economic slowdown and uncertainty can ensure the company stays “top of mind” for equity investors. Among individual companies, prowess in navigating such an environment is always a critical element looked for by equity investors and analysts. However, momentum is more than individual equity position behavior. It is also about an index or industry group which is moving at a pace and breadth that seems to happen, regardless of one or several indicators which might lead to more of a steady, albeit slower, pace and degree.

If momentum stocks continue to rise such that they create a trend or pattern of stock price appreciation greater than earnings growth, valuations may eventually correct to “right size” equity prices with actual profits. This adjustment in investor expectations can be further amplified by shifting market conditions that lead to downward revisions in earnings forecasts, leaving prior price gains exposed to a more pessimistic outlook. Sector rotation, driven by macroeconomic developments or evolving industry dynamics, can also cause momentum in equity markets to slow, if not stall. For example, the Federal Reserve cutting short term rates could lead

to investors seeing rate sensitive industries such as Utilities being more attractive, reallocating capital from other industries to fund purchases.

Cautious optimism continues to support equity markets, with investors seeking positive developments to reinforce expectations of sustained momentum. Expected rate cuts, productive trade talks, and resilient consumer spending are several examples of support for acceptable earnings data. While ongoing weakness in the labor market could introduce short-term volatility or modest pullbacks, longer-term business investment appears less dependent on shorter term data and more influenced by broader, structural forces such as AI evolution, shifting demographic trends, and accommodative government actions supporting economic growth and corporate balance sheets. ♦



ALM STRATEGY

With the Fed Now Easing (Again), How Does That Impact Our Approach to Balance Sheet Management?

In potentially the least shocking cut of all time, the Fed lowered the Funds rate 25 basis points in September. This cut was widely anticipated by investors, as are the likely next two cuts of 25bp before the end of 2025, but there is quite a bit more uncertainty about what will happen in mid-2026 once the new Fed Chair is announced. Last quarter we discussed this scenario, as well as what may happen on the way to the summer of 2026, and so far it has followed that anticipated path. However, now that loan rates are 25-50bp lower and funding costs have declined as well, should we continue with the same plan?

Changes in the Market Over the Last Quarter

Until recently, there was an odd pricing dynamic regarding residential mortgages and commercial real estate, in that CRE pricing was below that of resi mortgages. Historically, due to the additional credit exposure in CRE loans, the rates were higher than for resi, but that inverted a few months ago. Largely driven by intense pricing competition in the CRE market, that lasted for a couple of quarters,

but has now reverted back to more 'normal' pricing, with CRE slightly above. Market rates for 30-year mortgages stand near 6% currently, with CRE 1/8 to 3/8 higher, but both are lower than last quarter, and trending down.

How Multiple Additional Cuts Near the End of 2025 Impact Balance Sheet Strategy

Although rates at the short end of the yield curve will decline nearly in tandem with Fed action, longer rates are another matter. A portion of the move has already been priced in, given that the 5- and 10-year Treasury rates already trade under Fed Funds, and as a result, longer rates may decline, but at a slower pace. Given this dynamic, it is likely that funding costs will reprice more quickly than loans as rates fall, so a continued approach of shorter CDs combined with high yield savings / money market accounts and short borrowings appears to be best course of action. If we update last quarter's example in much simpler form, spreads should continue to widen based on the following:

- 5 Yr CRE rate of 6.125% could decline modestly to 5.875% with 50bp in Fed cuts
- CD rates could fall more than 25bp, but likely not the entire 50bp
- Short term borrowings should fall by the entire 50bp

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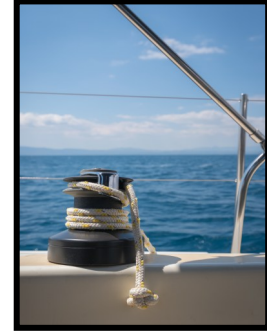
- Higher yield Sav/MMDA will likely decline between 25 and 50bp

In total, we end up at the same place as in recent months- lending at current rates, funded short, with the expectation that spreads will widen as funding reprices lower with Fed action. What continues to be a bit surprising is the lack of demand for longer term CDs, essentially anything over 18 months (which historically has been considered only a medium term). CD buyers should understand where rates are headed, and as such, a 5-month CD at 4% today (there are still 4's out there) may be hard to pass up, but the roll rate will almost certainly be below that a few months down the road. If that CD is rolled at 3.50% in 5 months, then rolled again 5 months later, it is easy to argue that an 18 month today at 3.75% provides a higher average rate over the entire holding period.

The Mortgage Market and Prepayment Speeds

In general, mortgage prepayment speeds remain below historical 'normal' levels, but seem to be rising with falling rates. However, this is not due to typical refinancing, as about 70% of current mortgages are below 5% (per Google) and would not be a suitable candidate based on today's rates. The increase is likely due to a small amount of higher rate refinancing (those with rates in the high 6% range or above) combined with a

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larger dose of ‘life event’ prepayments. There is a pent-up demand to move among homeowners with low, pandemic era rates, but making the decision to sell a home with a 3% mortgage and buy a new home with a 6.5%-7% rate is extraordinarily tough. As rates fall, the decision becomes easier, and with rates now at 6% and trending lower, speeds should increase as more homeowners decide to move now that the negative rate impact has lessened.

Along with increased activity, we have seen more financial institutions move back into the residential mortgage market. This number of banks and credit unions holding mortgages on balance sheet is lower than historical levels, but is certainly higher than in the recent past. Given today’s rates near 6%, and with the likelihood that rates may fall only modestly as the Fed eases (as a portion of the move is already priced in), the prepayment profile looks appealing. Even though these assets generally carry a longer average life than CRE loans, being ‘stuck’ with a 6% loan feels quite different than when the rate is 3% or lower.

An Update on the Powell Out Scenario

With Fed Chair Jerome Powell’s term concluding in May, the most likely outcome is that the new Fed Chair will come in with a mandate to lower rates, maybe aggressively. In that event, the front end of the curve would decline, lowering funding costs such as FHLB borrowing, short CDs and high yield non-maturity

deposit accounts. The real question, however, is what happens to the longer end of the curve. It could go in a few directions, largely based on how the economy is performing:

- If the economy is weak, then rates cuts would be warranted; the front end of the curve would decline, along with the back end as investors buy the long end into a slowing economy.
- If the economy is even moderately strong, rate cuts may be unnecessary; the front end of the curve would decline, but the back end may not cooperate. Investors could view rate cuts in a strong economy as inflationary and push longer rates up. This would lead to wider margins, as deposits rates fall while loan rates rise, but would likely be temporary because rising inflation would force the Fed to raise rates down the road.

The other point to consider is that falling rates will not benefit all institutions equally; those that have raised rates more aggressively than average will see a larger benefit as rates fall. However, for those that have lagged and already have low deposit costs, there will not be as much room to cut. The good news there, though, is that they have already benefited from lower funding costs throughout the cycle. ♦

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