



LM Capital Group Perspectives

Investment Insights

3Q 2026



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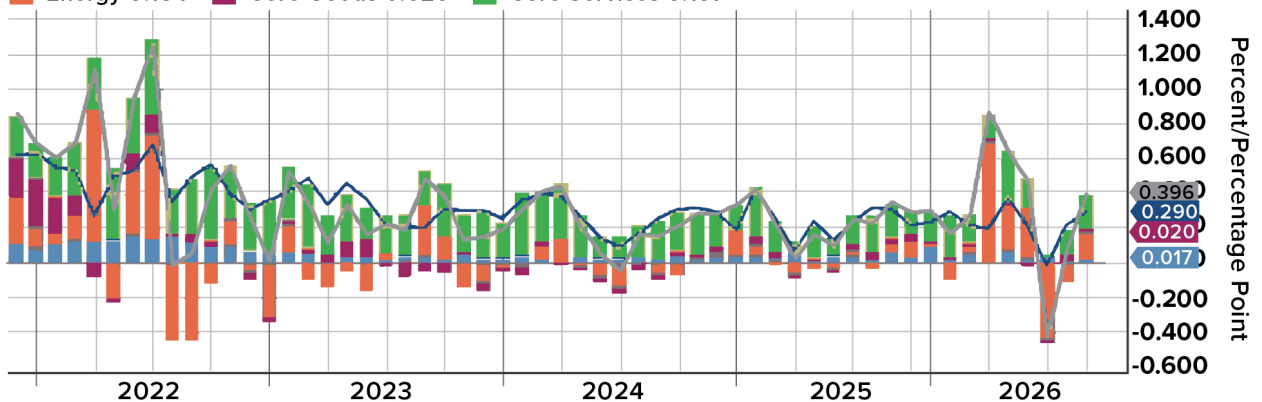
Where's the Ceiling for US Rates?

The US economy maintained resilient momentum through the third quarter, underpinned by a robust labor market and strong consumer spending, even as inflation remained stubbornly above the Federal Reserve's 2% target. August nonfarm payrolls topped all estimates, with the unemployment rate holding steady at approximately 4.1%, while real personal spending surged 0.6% in August - its fastest monthly pace since March 2025. Headline CPI stood at an estimated 3.4% year-over-year for the quarter, and core PCE rose 0.2% month-over-month in August, slightly below the 0.3% consensus estimate, though PCE prices were still running at 3.4% annually. A notable early-quarter development was the June CPI print, which showed consumer prices falling 0.4% month-over-month - the first monthly decline since 2020 - briefly easing rate-hike pressure, but that relief proved short-lived. The August core CPI came in at +0.3% month-over-month, above the 0.2% forecast, reigniting tightening expectations heading into the September FOMC meeting.

Contributions to US CPI MoM% SA

All items 0.396 Core CPI 0.290 Food 0.017

Energy 0.154 Core Goods 0.020 Core Services 0.197



Series	Ticker	Feb-26	Mar-26	Apr-26	May-26	Jun-26	Jul-26	Aug-26	Weight
All Items	CPI CHNG Index	0.267	0.865	0.640	0.473	-0.422	0.074	0.396	
Core Services	ECANXLPR Index	0.163	0.137	0.301	0.177	0.019	0.137	0.197	60.272
Core Goods	ECAN4IJ3 Index	0.016	0.021	0.006	-0.022	-0.016	0.037	0.020	18.842
Food	ECAN6AYN Index	0.054	-0.001	0.068	0.021	0.028	0.011	0.017	13.540
Energy	ECANZX50 Index	0.040	0.396	0.270	0.290	-0.445	-0.110	0.154	7.347
Core CPI	CPUPXCHG Index	0.216	0.196	0.376	0.208	-0.017	0.215	0.290	

Source: Bloomberg

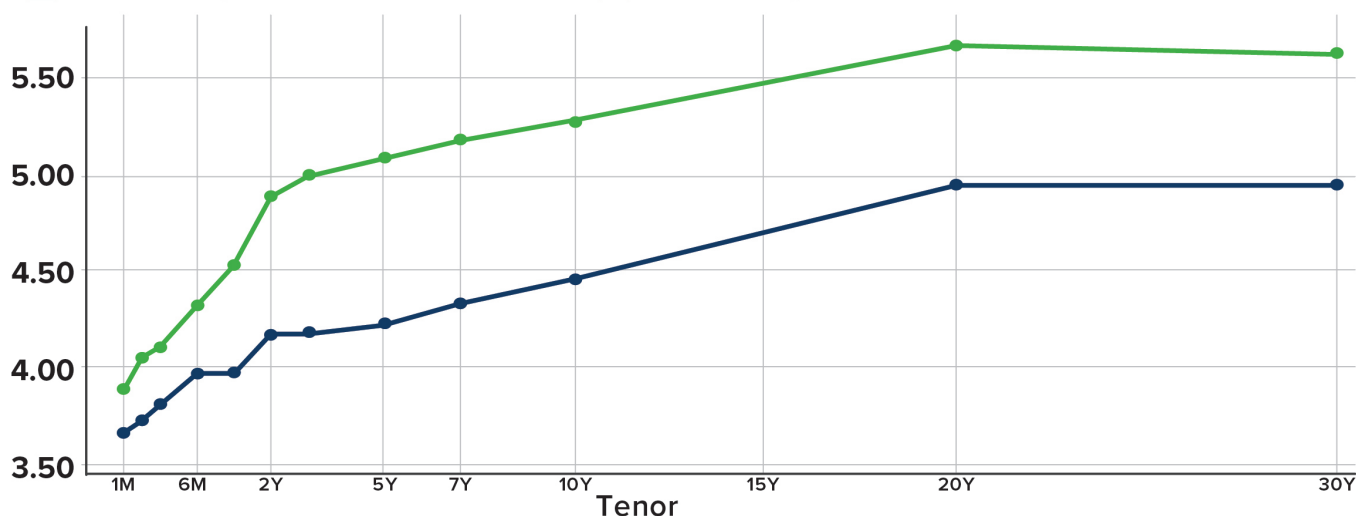
The Federal Reserve responded to persistent inflation by raising the federal funds rate 25bps at their September meeting with Fed officials striking a consistently hawkish tone throughout the quarter: A notable thematic mentioned a few times was the Fed's concern over AI-driven demand as a structural inflation driver. Two Fed officials at the Jackson Hole symposium in August suggested the current rate setting may actually be too accommodative rather than restrictive, which caught the market by surprise. By quarter-end, the market tempered its hike expectations slightly – pricing just one more hike by year end.

During the quarter US Treasury yields surged across the curve, with the move accelerating sharply in September following the Fed hike and hawkish forward guidance. The 10yr yield rose from 4.47% at the start of July to 5.29% by quarter end, while the 5yr climbed to close above 5% at 5.09%. The 2yr yield ended the quarter at 4.89%, and the 30-year reached 5.63% - its highest level since 2002 - producing a modest bear steepening of the curve as longer maturities rose in absolute terms to multi-year highs.

US Treasury Yield Curve

■ US Treasury Actives Curve 06/30/26

■ US Treasury Actives Curve 09/30/26



Curve Id	1M	2M	3M	6M	1Y	2Y	3Y	5Y	7Y	10Y	20Y	30Y
09/30/26	3.890	4.053	4.110	4.325	4.538	4.887	4.998	5.086	5.188	5.285	5.671	5.629
06/30/26	3.657	3.726	3.810	3.969	3.975	4.172	4.181	4.227	4.336	4.465	4.960	4.951
Difference	23.3	32.7	29.9	35.6	56.3	71.5	81.7	85.9	85.2	82.0	71.2	67.7

Source: Bloomberg

Credit markets also came under pressure, particularly in September as investment grade OAS widened from 26bps at the start of the quarter to 31bps at quarter-end while US high yield OAS expanded from 267bps to 311bps. The high yield sector had briefly tightened through August before reversing sharply in the final weeks of September as rate-hike expectations intensified once again.

The US dollar gained +0.26% this quarter, its fifth straight positive quarter as the market reprices inflation expectations and pulls rate hikes forward. The US Corporate (-3.94%), Mortgage-Backed Securities (-4.25%) and sectors lagged the benchmark's total return of -3.51% this quarter. The Emerging Market Debt (-3.46%), U.S. Treasury (-3.04%), High Yield (-1.82%), Government Agency (-1.79%) and Non-Dollar (-1.79%) all beat the benchmark's return.

USD Investment Grade OAS

■ ETF I-Sprd 148 ■ All Cash Bonds 118



Source: Bloomberg

Market Outlook

The fixed-income market is currently recovering from the Fed's sudden need to fight inflation for the sake of fighting inflation. The Fed realized that dismissing a tariff here and an oil price hike there, as one-time events that didn't affect ongoing inflation, was a bad idea. To reduce inflation expectations, the Fed decided that it must be seen as being firmly committed to fighting inflation.

Right now, the market is expecting one Fed rate hike in 2026. The Cleveland Fed's "Inflation Nowcasting" is predicting that on October 14, we will get a MoM CPI increase of 0.53% and a Core CPI increase of 0.20%. The YoY Core CPI is expected at 2.39%. That's pretty close to the Fed's 2.00% target, right? So, expect angry speeches against inflation after the October 28 Fed meeting, rather than a rate hike.

It is too soon to determine whether the war in the Middle East will leave any long-lasting inflationary effects. Restocking effects may keep prices elevated. Residual inflation may take a while to work its way out of the economy. As of October 2, gasoline prices nationally are about 47% higher than they were on the last business day in February. Diesel fuel prices are more than 69% higher.

Someday soon, we may once again care about the tug of war between jobs and inflation. But right now, the latest U.S. unemployment rate is 4.2% and nobody in "the market" is worried about the jobs picture.

In the long term, we remain concerned about weaker demand for the U.S. dollar from international investors. As long as real yields in the U.S. remain elevated, the international capital needed for the AI buildout should flow. Despite the numerous news stories about the flood of bonds being issued by AI-related companies, no issuer can keep up with the U.S. government. The unlimited appetite of investors for US Treasuries will be tested if international equity investors start to question the AI/data center US growth story.

The U.S. economy appears to be strong, but not too strong. Spending on data centers and the reshoring of manufacturing facilities should support US growth. Worries about tariffs have receded.

For October, we are maintaining our cautious stance. Durations are generally close to the benchmark indices. The recent rise in U.S. Treasury rates has made corporate credit, even with its very tight spreads, attractive once again. As long as the economy remains strong, and rates are at current high levels, we think "the market" will find short and intermediate corporate credit too attractive to ignore. With the market seeing one rate hike as certain, but with a chasm of uncertainty after that, we think that there is a good chance that short and intermediate yields come down a bit. We are positioned for a yield curve steepening, despite the recent curve flattening. As inflation appears to be a continuing concern, we maintain exposure to Treasury Inflation-Protected Securities (TIPS). Despite our aforementioned stance on real rates, we're worried that the recent increase in real yields may not have staying power. We have the TIPS as an insurance policy.

We expect positive fixed-income returns for Q4 2026, dominated by buyers of the irresistible yields on bonds. If there is a whiff of fear in credit markets, we expect it to be largely offset by lower rates in the US Treasury market. We believe that the risk of a sudden change in market sentiment is relatively high, and we worry about the mid-term elections jolting people's expectations. We are biased towards adding credit on significant spread widening and changing our key rate duration weightings as the US Treasury market moves.



Pablo Barrientos

Senior Credit Analyst

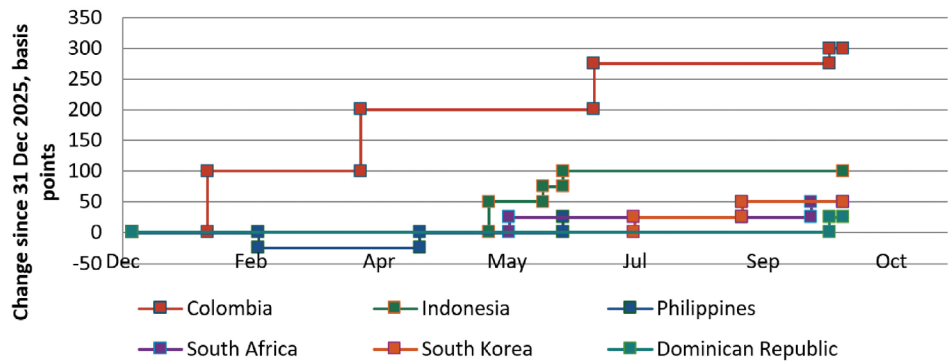
U.S. rates were the other drag. The 10-year Treasury posted its largest quarterly rise since 1994 and finished September near 5.3%, the highest since 2002, as inflation stayed above target and deficit concerns kept the long end under pressure. Most EM currencies weakened with that move, with the local-currency complex, measured by the EMLC ETF, finishing the quarter down about 1.5%.

However, higher (and increasing) local policy rates limited the damage and attracted flows into EM dedicated debt funds, mainly those with local currency mandates.

Emerging Markets 3Q 2026 Review

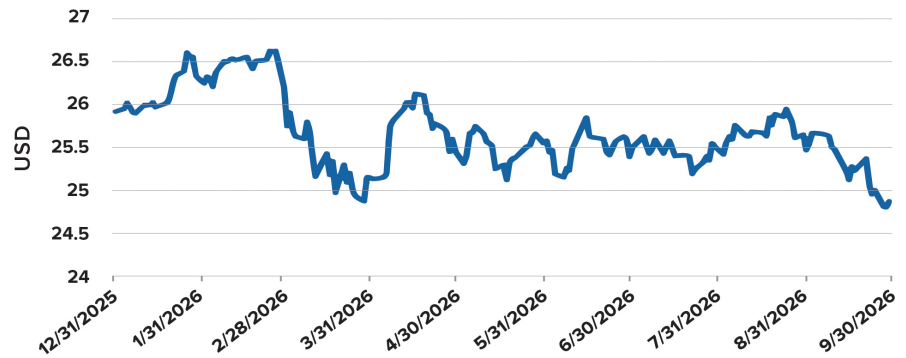
Emerging market debt had a mixed third quarter. Oil stayed high, El Niño added to food-price pressure, and a few central banks turned more hawkish, offsetting a primary market that remained busy after a record first half.

EM central banks that have hiked in 2026



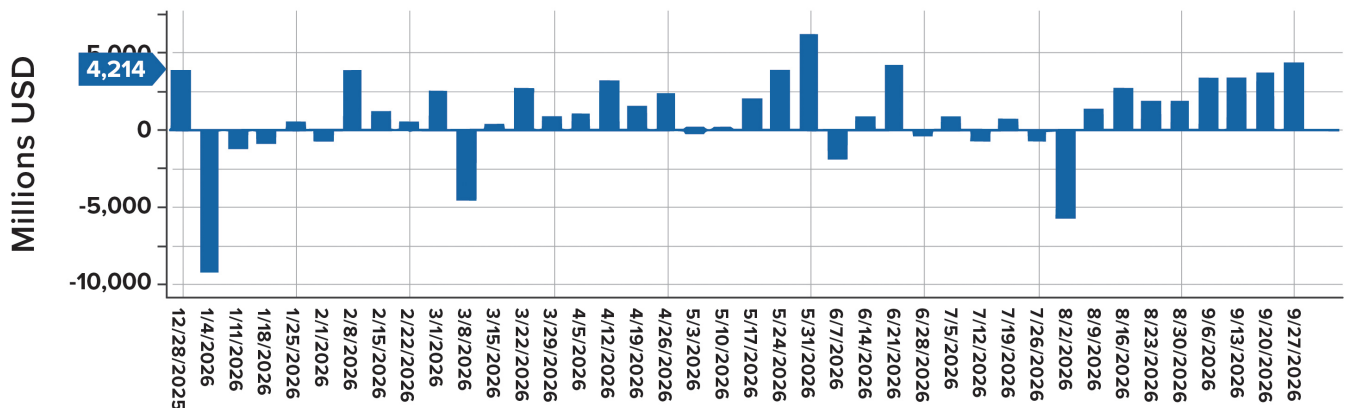
Source: Bloomberg

Vaneck JPM EM Local Currency Bond ETF



Source: Bloomberg

Fixed Income ETF Flows



Source: Bloomberg

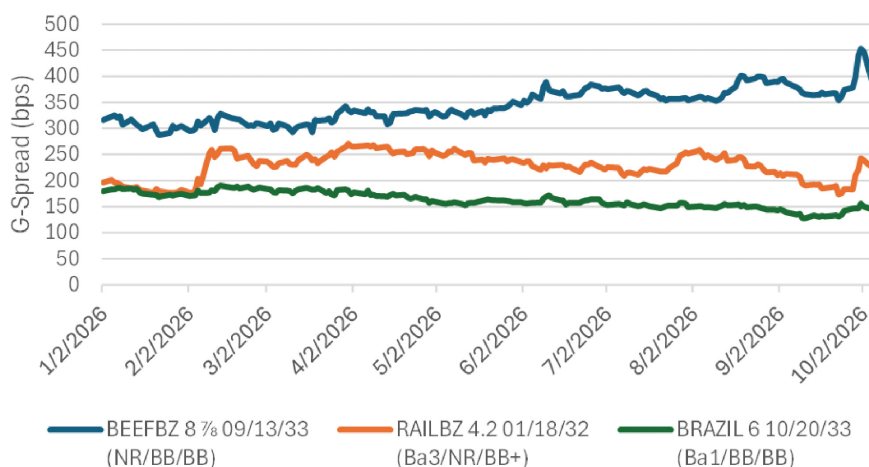
Politics mattered as much as the macro data. In Brazil, assets turned volatile into the October 4th presidential election first round as polls stayed tight between Lula and Flávio Bolsonaro. Bolsonaro finished first, with about 47% of valid votes to Lula's 45%, short of the 50% needed to win outright, so the race goes to a runoff on October 25th. The result beat polls that had Lula ahead, and Brazilian assets rallied at Monday's open on the prospect of a more pro-business government, with the real appreciating nearly 5%. The volatility around the elections during the third quarter opened entry points in select credits, including Minerva and Rumo, as discussed in our recently published "Brazil: the case for selective exposure." In Europe, Romania still has no government after a third failed nomination in late September. Sovereign spreads widened as the deficit path and the investment-grade rating stayed in question. The backup versus similarly rated credits is still worth watching for selective entry points.

We stay constructive and selective, with high-conviction exposure in commodity-linked countries where policy is turning or continuity is clear (e.g., Brazil and Colombia). Liability management and an open primary market should keep technicals supportive in sound names, even if currencies and global rates stay unfriendly.

For the rest of the year we are focused on:

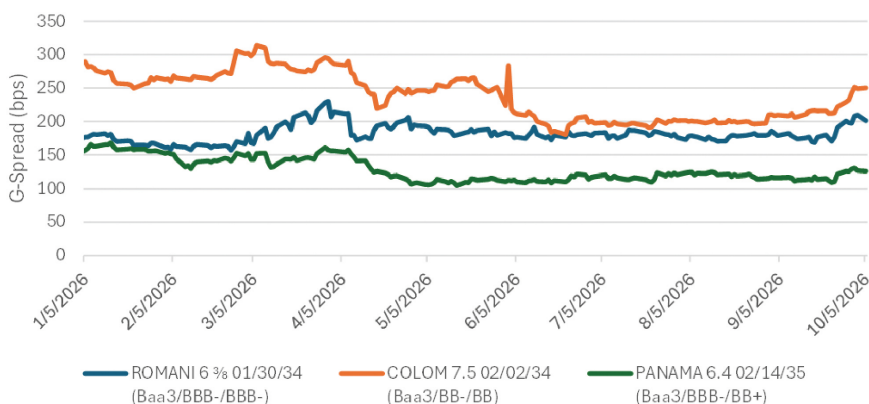
- Brazil's October 25th runoff, and what a Bolsonaro government would mean for trade with the U.S., China, and the EU.
- U.S. midterms and the read-through to global rates.
- Oil, including the Iran conflict and any further supply disruptions.
- Whether China's stimulus shows up in commodity markets.
- El Niño into year-end and the Southern Hemisphere summer.
- The delayed October round of USMCA talks with Mexico, including the separate negotiation on steel, aluminum, and auto tariffs.
- Whether Romania can seat a government before credit rating committees lose patience.

YTD Spread Performance of Select Brazilian Bonds



Source: Bloomberg

Romania Spreads Increasingly Becoming More Attractive



Source: Bloomberg



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Disclosure: LM Capital specializes in active fixed income management using a top-down, macroeconomic approach supported by in-depth, bottom-up research in an effort to provide attractive risk-adjusted returns.

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