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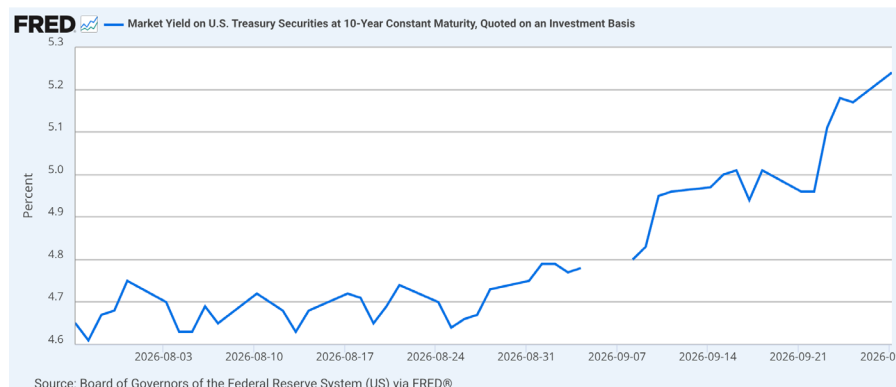
## BOND BOOST

If you look at the change in the yields on U.S. 10-year Treasury bonds over the last couple of months (since the first of July), the chart is eye-opening. This may be the economic story of the hour. The press seems focused on whether or not the U.S. stock market is moving up or down on a daily basis, but under the waves, there seems to be something happening on a structural level.

What could cause such a dramatic surge? Some say the \$40 trillion federal deficit is spooking longer-term bond investors, who wonder how the government is ever going to pay its way out of this massive fiscal hole. A default seems unlikely, but it also seems a bit unlikely that any future Congress will authorize an annual budget that collects more than it pays out. (This last happened during the Clinton Administration.)

Basically, that means government bond rates may go higher to compensate.

Another factor that is undoubtedly contributing to the higher



rates is competition—specifically, from the tech companies that are hungry for outside capital to fund construction of their massive (and massively expensive) data centers. Very few borrowers have the scale to compete with Treasuries, but this year the various AI-related firms will issue \$489 billion in high-yield bonds, and they're paying 2.25% a year more than comparable Treasuries. By one estimate, the total AI-related debt issuance could reach \$4.1 trillion through 2030. Put another way, the tech industry is outbidding the government for investment dollars.

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Then there's inflation. Core inflation has been steady at 3.7%, which is nearly twice the goal of the U.S. Federal Reserve Board. Investors calculate the 'real' return on their bond holdings by the simple exercise of subtracting the inflation rate from the yields. The current 5.3% yield on 10-year Treasuries offers a 'real' return of 1.6% a year—which some investors might say is pretty skimpy. And the renewed U.S.-Iran conflict has raised concerns about how energy prices might impact that inflation rate, which means the 1.6% return could be considered unusually risky.

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# BOND BOOST

How will this affect ordinary investors like us? If rates continue to rise, and even if they hold steady, the government will have to pay out considerably more on its gargantuan borrowings than it has been over the last 20 or 30 years. Interest payments already consume more of the government's budget than military spending—and, it should be noted, interest payments eat away at the government's ability to spend on its priorities.

Another effect could hit consumer wallets. Banks and lending institutions base the rates they offer consumers on the 10-year note,

which means rates for home equity, auto loans and other debt are rising basically in lockstep. A typical 30-year mortgage is now priced at 7.26%, nearly a full percent over what home buyers could have gotten at this time last year.

Finally, when bond rates are this high, they start to compete with stocks for the attention of investors. Does the market offer a guaranteed 5.3% annual return over the next ten years? Stocks generally outperform bonds, but the margin tends to tighten when bond rates go up—meaning that some conservative stock buyers

could decide to become bond buyers instead. If the upward trend continues for bond rates, it could eventually start to affect the stock market's performance.

None of this signals a crisis. It's an underlying story that will eventually resurface in the press—and if the past is any indication, the headlines will suggest that this is leading to an incipient catastrophe. When you encounter that breathless clickbait, you'll know what's actually going on.

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# PENNY POLICIES

**T**he U.S. government's mint is no longer manufacturing pennies, and has not been since the beginning of last year. The decision is reasonably logical; it was costing the mint roughly 3.69 cents for each penny it made in 2024, for a total cost of \$18 million that year. And who uses pennies any more?

Apparently, many retailers were concerned that they wouldn't be able to have enough of the 114 billion pennies currently in circulation to make change for cash customers. (There may be an equal number stored away in home coin jars, piggy banks and junk drawers.) So after a bit of lobbying, Congress has passed the Common Cents Act, which permits retailers to round cash transactions to the nearest five cents in situations where neither the buyer nor the seller has exact change.

Specifically, whenever the price ends in a 1, 2, 6 or 7, merchants may round it down to the nearest sum divisible by 5—meaning either 5 or zero. Thus an item that costs (with tax) \$21.02 would, if the buyer is paying cash and neither party had pennies, the cost becomes \$21.00. If the item cost \$21.06, then the price would become \$21.05.

But if the price ends in 3, 4, 8 or 9, the merchant would be allowed to round the price up to something ending in 5 or 0. (\$21.03 becomes \$21.05, while \$21.08 becomes \$21.10.)

Under these rules, neither consumers nor retailers, in aggregate, come out ahead.

Before the mint shut down pennies, they accounted for more than half of its annual output. Now some are wondering about the nickel, which is larger and made of more expensive metals. The government

spends 13.78 cents to produce each nickel, and in a typical year it will produce 6 billion of them. If there's no widespread pushback on the penny's demise, then look for the government to have retailers round up, or down, to the nearest dime.

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## SHINY OBJECTS

**W**e probably shouldn't be surprised that the diamond market is eroding dramatically. How dramatically? Natural diamonds—the kind you dig out of the ground—are selling at roughly half the price they were five years ago.

Why are we not surprised? For one thing, diamonds are not nearly as scarce as most people believe them to be. The De Beers cartel controls how many diamonds go on the market, keeping the prices (until recently, at least) higher than they would have been otherwise. The control slipped briefly as a glut of mined stones have hit the market, and this is revealing what economists might call their 'true value.'

But a bigger issue is lab-grown diamonds. These are not the old cubic zirconia simulated material made from zirconium dioxide, which fade in color and clarity simply with exposure to the air and environment. Today's lab-grown stones are chemically identical to the stones that miners dig out of the ground—except that if you happened to find a natural diamond lying in your front garden, there's a good chance it would have flaws of various sorts. Lab-grown diamonds can be made perfect. Even in today's market, a perfect lab-grown diamond with an excellent cut can cost one fifth the cost of a comparable (but, remember, slightly flawed) natural stone.

This, of course, has shifted consumer demand—to the extent that last year 61% of all engagement ring sales were lab-grown diamonds, an increase of 239%

### One-carat diamond prices are sliding

The Rapaport Trade Diamond Index, or RAPI, for 1-carat diamonds, which tracks average asking prices for round D-H color stones with high clarity, fell 51% between Sept. 1, 2021, and Sept. 1 2026.

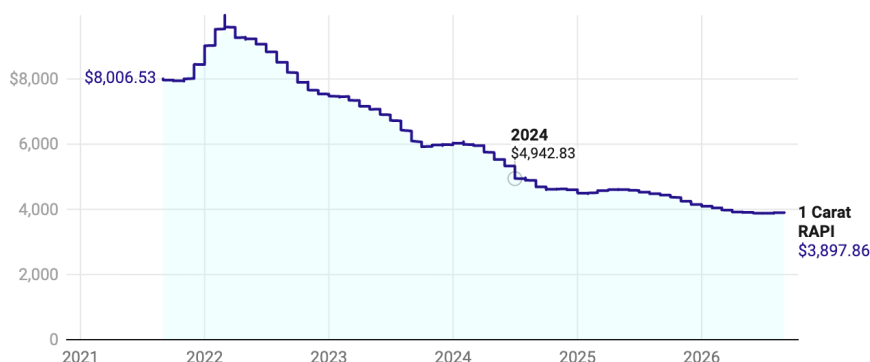


Chart: Elizabeth Napolitano (CNBC) • Source: Rapaport • [Get the data](#) • Created with [Datawrapper](#)

since 2020. The traditional diamond industry isn't taking this lying down. The De Beers organization has announced a halt on mining its Venetia mine in South Africa for the next two years, hoping that limited supply will push prices back up. Two other mines have filed for bankruptcy.

Interestingly, the negative price trend is not happening with colored gems. Rubies, emeralds and sapphires are experiencing a 15% price rise, year over year, while opals and tourmalines are becoming increasingly valuable as well. Currently, Burmese 'Pigeon Blood' rubies are the most expensive colored stones in the world.

Another trend has entered the picture: documented sourcing. All of the gemstones are considered more valuable if their provenance—where they come

from—can be proven not to involve human rights abuses, violent rebel groups (see: blood diamonds) and/or environmental destruction.

Most market commentators would agree that gemstones are not an ideal investment; like gold, they don't produce dividends, and their future prospects are somewhat less certain than company stock, where the company is constantly engaging in activities that would increase its value and market share. Diamonds are a cautionary tale; anyone 'investing' in diamonds is looking pretty foolish after these last five years.

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# 2026 THIRD QUARTER INVESTMENT REPORT

**A**fter the rousing returns of this year's second quarter, the third quarter was a bit sleepy, with the markets eking out incremental gains pretty much across the board. For most asset classes, it was a matter of holding onto the gains earned earlier in the year.

Despite the slowdown, most investors are experiencing high-moderate returns so far this year. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—gained 1.62% in the third quarter, and is now showing a gain of 12.82% for the year so far. The comparable Russell 3000 index is up 12.72% since the beginning of January.

Looking at large cap stocks, the widely-quoted S&P 500 index of large company stocks gained 2.03% in the third quarter, posting an overall gain of 11.77% as of the end of September. The Russell 1000 large-cap index has delivered a 12.59% gain in the first nine months of the year.

The Russell Midcap Index, meanwhile, has gained 12.50% for the year so far.

As measured by the Russell 2000 Small-Cap Index, investors in smaller companies are holding onto a 14.11% gain. The technology-heavy Nasdaq Composite Index gained 1.27% in the third quarter, and is sitting on a 20.43% gain for the year.

Foreign market returns are following the same general trend. The broad-based EAFE index of companies in developed foreign economies gained just 0.01%, in dollar terms, in the third quarter, to hang onto a 7.76% gain for the first nine months of 2026. European stocks, in aggregate, lost 1.59% of their value in the three months ending September 30, but have managed to deliver a 4.24% gain for the year, while the Far Eastern index gained 3.78% for the quarter, to post a 17.11% return for investors so far. Emerging market stocks of less developed countries, as represented by the EAFE EM index, posted a 1.23% loss for the quarter, and a 2.11% gain for the year so far.

Real estate securities suffered the most during the recent quarter. The S&P U.S. REIT index lost 5.81% in the third quarter, but has still managed to deliver an 8.88% return for the first three quarters of the year. Meanwhile, the S&P GSCI index, which measures commodities returns, was lifted by higher oil prices, rising up 17.91% in the third quarter, to post a 33.16% return since January 1. Utility stocks fell 13.03% for the quarter, which has led to a negative 7.65% return for their investors since January 1.

In the bond markets, yields are up dramatically over the last quarter. Treasuries of 3-month duration have

jumped from 3.75% yields to (currently) 4.11%. 6-month Treasuries have risen from 3.93% three months ago to 4.33% today. The same story holds for one-year (3.92% to 4.54%), 5-year (4.23% to 5.09%) and especially 10-year government bonds (4.48% to 5.28%). Treasuries with 30-year maturities are now generating 5.63% annual coupon rates. Five-year municipal bond rates, meanwhile, have jumped from 2.56%, in aggregate three months ago to 3.73% today, while 30-year munis are yielding 5.25%.

The robust gains of the second quarter are largely forgotten now as the markets have decided to take a 3-month pause. We can never know for sure what drives market psychology, but a measure of that psychology--the Conference Board's monthly survey of consumer confidence--has been trending lower since the middle of 2021, even as consumer spending has remained strong. Part of the strong spending trend can be accounted for by the cost of necessities going up, but there's also a worrisome trend of Americans being increasingly willing to take on credit card debt.

Meanwhile, second quarter GDP rose a respectable 2.2%, roughly the same pace as the first quarter, which means the economy still seems to be humming along. Of course, a gloom and doom analyst might point out that

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# 2026 THIRD QUARTER INVESTMENT REPORT

the huge, unprecedented spending on AI data centers and equipment has goosed up that number. And the recent tax cuts, combined with the enormous (and growing) federal deficit means that the economy has been receiving a bit of a sugar fix.

Talk show pundits and Wall Street analysts will peer at this data through their crystal balls and tell us with confidence what nobody can know: what it all means for the future, especially the future of the markets. The third quarter pause in the markets doesn't tell us

whether the next quarter, next year or next decade will be generous or stingy with returns. The market roller coaster didn't exactly dip, but it did level out a bit. The next movement up or down is still hidden around the corner.

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