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THE CAPSTONE QUARTERLY

Markets are always shaped by a mix of optimism, innovation, and uncertainty. This quarter, we take a closer look at two areas receiving significant attention: the growing conversation around a potential AI-driven market bubble and the role that bond yields may play in the investment landscape ahead.

BRYCE'S POINT OF VIEW

Bryce Pease, CFP®

AI Bubble?



I've never been one to predict markets, and I certainly won't start now. But I've been in this business for many years. I've seen good times, bad times, and everything in between.

Right now, we are seeing a ton of excitement and cash spent building AI and all the infrastructure around it. This isn't the first time a new technology has come along and changed the world. We saw the steam engine and railroads spread throughout the country. From the first glimmer of light in Thomas Edison's workshop to the modern power grid we have now. Diseases that would have killed you fifty years ago are now nothing more than a mild inconvenience. And of course, the internet and personal computer changed everything too.

All were exciting. All changed the world. All were expensive. And all, at some point, were overbuilt or overexpanded. Each brought change, excitement, capital spending, and yes, fear.

That leads me to where we are today. There is more and more fear building around AI. Not just the technology itself, but the capital spent on it and the debt taken on to fund that spending. Debt that has many people wondering: Is this a bubble?

We are often asked that question about various sectors in the markets. "Is this a bubble?" Our answer: We have no idea. We honestly believe no one knows that with any real certainty. Nobody rings a bell at the top.

Here is what we do know. If it does turn out to be overbuilt, history tells us these things tend to unwind over

time, not all at once. That doesn't mean there won't be sharp moments along the way; there usually are. We watch valuations, debt levels, and how companies are actually spending that capital. That is what active management is for. Not for predicting the future, but paying attention to it.

While I believe active management to be a real advantage, it does not mean we are shielded from a dip. Most of our clients still hold equities (stocks), and they move with the broader market. If stocks fall, we will feel some of that too. What active management gives us is the ability to make decisions during that fall and try to protect principal, not immunity from it.

We own equities by choice, because we believe you have to own stocks in a world of ever-increasing prices. Stocks have historically been one of the only investments that consistently increases your purchasing power over time. That growth comes with a price, however. Going back to 1945, the average bear market has brought a decline of around a 1/3.¹ It is also worth remembering that every one of those bear markets ended, and the market went on to new highs afterward. The pain has always been temporary, and the growth has always outlasted it.

This article isn't meant for doom and gloom; it's far from that. We are optimistic about the long-term future of our investments. But we've done this long enough to know that rough seas can arise from time to time. Markets have always moved through periods of uncertainty, volatility, and change, but history has shown that patience, discipline, and a well-designed plan can help investors navigate those challenges. As we look ahead, we remain confident in the opportunities that innovation, economic growth, and human resilience can create. Our focus

remains on staying invested, staying prepared, and continuing to build toward the financial goals that matter most to our clients.

CASEY'S CORNER

Casey Morris, CFP®

Bond Yields



Imagine you are lifting weights at the gym. You progress to even heavier plates, trying to lift each a total of ten times before moving on. Finally, you get to the real monsters – weights so heavy, you really must strain. Still, you're plenty strong, so you lift them once. Three times. Five times. Seven. And then you notice it: The wobble

in your arms. Each rep is getting harder. Your form is shot. Suddenly you realize that while you may get to ten, it's possible your strength will give out. You could pull a muscle or even drop the bar on yourself. It's a risky situation.

This is my analogy for understanding what's going on with bond yields right now...and its relationship to both the economy and the stock market. By this point, you have probably seen at least one headline about bond yields this summer. Those headlines have intensified in recent weeks. Because while the stock market is strong and the economy able to bear a lot of weight, that weight is getting heavier and harder to lift...in the form of bond yields rising to heights we haven't seen in years.

The bond market is an important topic. In fact, when it comes to the economy, you can make the case that it's far more important than stocks. We don't talk about it often, because most of the time, bonds – specifically, U.S. Treasury bonds – hum along in the background, quietly being the backbone of our entire financial system. But there are times when they demand the spotlight. This is one of those times.

Bond yields (I'll explain what they are in a moment) have been rising quickly for several months now. In May, the yield on 30-year Treasury bonds hit their highest level since 2007, and while they dipped for about a month afterward, they have climbed even higher since. The yield on 10-year Treasury bonds took a little longer to make headlines, but they recently hit 19-year highs, too, reaching nearly 5% on September 15th.² These spikes have caused volatility in the stock market, and a flurry of action in Washington.

A bond's yield is the return an investor expects to gain until a bond matures. Yields can be determined by dividing the bond's annual interest rate payment by its price. For example, imagine an investor, whom we'll call Alfred, buys a bond with a 10% interest rate for \$1000. The bond's yield would be 10%, too. But now imagine that Alfred sells that bond to Ethyl a year later...but for \$75 more. Since the bond is being traded for more than its original value, the yield would go down to 9.3%. (After all, if Ethyl pays more than Alfred for the same level of interest rate, she's getting a lower return on her investment than Alfred did.) However, if Alfred sold the bond for less than he originally paid – say, \$975 – then Ethyl's yield would rise to 10.25%. Based on this example, we can see that yields and high-quality bond prices are inversely related. If a bond's price goes up, its yield will go down. If the price goes down, the yield goes up.

Now, you may occasionally hear the media refer to a bond's yield and its interest rate as essentially one and the same. This isn't technically true, but it makes things easier to understand. That's because, most of the time, bond yields and interest rates are directly related. If bond yields go up, interest rates go up. This is why yields matter. Because they indirectly determine how much it costs to borrow money nearly everywhere else in the financial system. Want to buy a house? Your mortgage rates are determined by bond yields. Want to buy a car? Same thing. Start a new business? Bond yields are your invisible boss. Student loans? Them, too. Bond yields may not make the world go round, but in a weird, opaque way, they

Did you know?

Martha Washington is the only real woman featured as the primary portrait on U.S. paper currency. Several other women have appeared on U.S. coins and in group vignettes, such as Susan B. Anthony on the \$1 coin, but Martha Washington is the only one to appear on paper currency so far.

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power it all the same. Now, here is where I should stop and clarify something: It's not all bond yields that wield this power. When it comes to determining interest rates, it's the U.S. Treasury market that acts as the wizard behind the curtain.

Right now, the surge in Treasury yields appears to be caused by our same culprits that have been influencing the markets in recent years: inflation, debt, and the overall health of the stock market/economy. Higher yields often lead to higher interest rates for everyday life. The immediate consequences become obvious for anyone who needs to borrow money. There is of course a lot more to the story than we have time for in this article but if we know the "why" behind the headlines, we can try to protect ourselves from overreacting to them. And if we are aware of the risks and challenges of a high-interest rate environment, we can prevent ourselves from being surprised by them. The same measured approach to weightlifting also works for investing. We must avoid overreacting to scary-sounding headlines, whether they're about bond yields going up, or oil, or inflation, or anything else. At the same time, we must be mindful about not getting over-exuberant – about AI, the stock market, you name it.

FINALLY...

In our last quarterly newsletter, we told you about the therapy dog program that Casey and John have been attending with two of their golden retrievers. This quarter we are pleased to announce that Casey and her dog Titan have passed the therapy testing as well. They can now begin volunteering together as a dog team at various de-stress events, schools, universities, senior and assisted living homes, and hospitals, to name a few where they will provide animal assisted therapy. For those of you familiar with Southern California, the name Titan comes from the mascot of the college that Casey and John met at – California State University, Fullerton.



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P.S. If you ever run across anyone who could use our services or is unhappy with their current adviser, we always appreciate it when you pass on our name.

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1 Since 1945, the S&P 500 has fallen an average of 33% during bear markets. Source: CBS News/PBS News, citing market data through 2025. <https://www.cbsnews.com/news/what-is-a-bear-market-stocks/>

2 "Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity," Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/dgs10>