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## Investment Newsletter – September 2026

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### Executive Summary

Some client accounts now have allocations to the new Quantitative Equity strategy, which is up almost 19% since June 1<sup>st</sup>.

There are important long-term risks and deadlines to consider when making Medicare insurance choices at age 65.

The large increase in Treasury bond yields has hurt the performance of interest-rate sensitive strategies: the Long-Term Income and the Real Estate portfolio.

### Quantitative Equity Allocations Update

The new Quantitative Equity strategy has started very strong. From its launch June 1<sup>st</sup> to September 30<sup>th</sup> 2026, it has returned 18.75% (before fees), beating the S&P 500 ETF by 17.4%. In September, moderate-risk allocations were adjusted to allocate 5% to 10% to the Quantitative Equity strategy. Other strategy allocations were adjusted so as to keep overall risk at the same targets as before. The main source of risk reduction was less money allocated to the Real Estate portfolio. The current rising interest rate environment is less favorable for this strategy and thus the shift should provide better returns for the risks. Some risk budget was also freed up by reducing exposure to the Long-Term Income portfolio.

### Making Medicare Insurance Decisions

Unless you still have employer-paid health insurance, at age 65 you must make some very consequential choices about your Medicare insurance coverage. You need to sign up within the required period or you face a lifelong penalty.<sup>1</sup> First, you need to understand the terminology. Medicare has four parts, each covering a different kind of care. **Part A (Hospital Insurance)** covers inpatient hospital stays, skilled nursing care after a qualifying stay, hospice, and some home health care, and is premium-free for most people. **Part B (Medical Insurance)** covers doctor visits, outpatient care, preventive services, and medical equipment for a monthly premium, plus a deductible and usually 20% coinsurance. **Part C (Medicare Advantage)** lets you get Parts A and B through a Medicare-approved private insurer instead. These plans often include drug coverage and extras like

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<sup>1</sup> If you're already receiving Social Security benefits when you turn 65, you're enrolled in Parts A and B automatically.

dental or vision, but they typically limit you to a provider network. **Part D (Prescription Drug Coverage)** covers outpatient prescriptions through private plans, either stand-alone or as part of a Medicare Advantage plan.

To avoid penalties, sign up for Part B during your 7-month Initial Enrollment Period, which starts 3 months before the month you turn 65 and ends 3 months after it. If you miss it, you can only sign up between January 1 and March 31, with coverage starting the following month. If you've gone 12 or more months without Part B by then, you'll pay a penalty for life. However, if you are covered by employer health insurance at age 65 through your or your spouse's current employer (with 20 or more employees), your deadline is extended to 8 months after the sooner of leaving employment or employer coverage ending. Also, if you are choosing traditional Medicare, you sign up for Part D insurance at the same time as Part B.

The Part B penalty for not signing up by the deadline is 10% of the monthly premium for each 12 months late. Because this is a percentage, the dollar cost of the penalty rises throughout your life along with the Part B premium. There is also a penalty for signing up late for Part D. You need to avoid these penalties!

Next is the decision about which way to go at sign-up – Medicare Advantage (Part C) or traditional Medicare (Parts A, B, and D). If you choose traditional Medicare, you will want supplemental insurance, known as Medigap, to cover the Part A hospital deductible, the coinsurance (20% share), Part B excess charges when doctors bill above Medicare reimbursement rates, and a few other uncovered items. The coverage of these policies is prescribed by law. I recommend the highest coverage plan, which is Plan G for new sign-ups. Once you've paid the Part B deductible, this supplemental insurance will effectively eliminate out of pocket costs for Medicare covered services. Note, however, that Medicare and Medigap don't cover routine dental, vision, hearing, or long-term care.

If you choose traditional Medicare to start, and you sign up within the Medigap Open Enrollment Period, you automatically get coverage at the same Medigap premium as a healthy person without a medical assessment of your health. There are also some rules about how long you can "try out" a Medicare Advantage plan and still go back and get a Medigap policy without proving you are healthy. Choosing Medicare Advantage and sticking with it past 12 months may mean going back to traditional Medicare without Medigap insurance because the insurers can then deny coverage or raise premiums after this 12-month period.

### **Medicare Advantage Plans Key Disadvantages**

There are many providers, and each plan is different, but they have some common disadvantages versus traditional Medicare. Here are the key differences compared to traditional Medicare:

1. They limit you to a network of providers (HMOs) or charge more outside it (PPOs), usually within a specific service area.
2. They have higher potential out-of-pocket costs compared to traditional Medicare when it is combined with a Medigap policy.
3. They have prior authorization requirements they use to ration care. If you talk to enough participants, you will hear horror stories of denied treatments.

4. Plans change from year to year and what was once covered may become uncovered or restricted via the prior authorization controls that they use to manage costs.

Details of these disadvantages are below.

Your care will only be as good as your Medicare Advantage network. If you belong to an HMO plan such as Kaiser, for example, you won't have insurance to see a doctor outside of Kaiser unless a Kaiser doctor refers you and their plan administrators approve out of network coverage. If you need to see a specialist at UCSF and Kaiser won't pay, you'll have to pay 100% of costs to see them. Except for emergency or urgent care, this also applies if you travel outside of Kaiser's geographic coverage area. PPO Medicare Advantage plans (as opposed to HMO plans) will cover some out-of-network doctors, but at higher costs than in-network doctors.

As mentioned earlier, you would have almost no out-of-pocket costs under traditional Medicare when combined with a Medigap policy. Medicare Advantage plans have varying out of pocket maximums. Just as an example, Kaiser's San Francisco Basic plan has an out-of-pocket maximum of \$6,000 for 2026.

Medicare Advantage plans are designed to make money (even those run by a non-profit like Kaiser). They market their low premiums and bonus benefits, but to keep premiums competitive, they sometimes deny expensive care even though it should be covered under Medicare rules. A Health and Human Services audit found 13% of denials were improper. In its report, HHS noted:

"Denied requests that meet Medicare coverage rules may prevent or delay beneficiaries from receiving medically necessary care and can burden providers."

Plans are paid a fixed amount per member, so every expensive treatment they deny increases their profit. If you are healthy, this situation may never come up, but everyone should consider this risk.

Even if you choose a great plan with few restrictions, there is nothing to guarantee it will stay that way. Chances are you won't realize how their coverage policies are changing until you need them. Then it is too late.

### **Medicare Advantage Plans Potential Advantages**

There are two main reasons you might choose Medicare Advantage over traditional Medicare, despite the disadvantages. The premiums are usually lower when taking into account the Medigap policy you'll want to have when choosing traditional Medicare. Second, it will probably be easier to get a primary care doctor because a plan will assign one to you. Finding a doctor under traditional Medicare can be difficult in some locations. Having said that, it does not mean you'll be able to get a timely appointment with your Medicare Advantage doctor (or a traditional Medicare doctor). California has a doctor shortage and it can take months to get an appointment either way, depending on your location.

### **Medicare Part D Drug Insurance Plans**

If you choose traditional Medicare, you will also need to pick a Part D drug insurance plan. The federal Centers for Medicare & Medicaid Services (CMS)

regulates these drug plans - but there is still a lot of flexibility on what each plan covers. Different plans have different premiums; costs also vary according to what drugs you need to take. The medicare.gov website lets you compare the annual all-in cost of plans based on the drugs you list. This is a great starting point, but it may not always be enough to choose the right plan.

All plans, by law, have an out-of-pocket maximum in 2026 of \$2,100 on covered drugs. This limit will rise to \$2,400 in 2027. Premiums do not count towards this maximum and neither does anything you pay for a drug your plan won't cover for you. There are many expensive specialty drugs where this can matter.

A plan can refuse to cover a drug for you in two ways. First, a plan's formulary (its list of covered drugs) must include at least two drugs in each class, but not necessarily the one your doctor prescribes. Drugs used for weight loss are excluded by law.<sup>2</sup> Second, even a drug on the formulary may require prior authorization (the plan must approve it before paying) or step therapy (you must try cheaper drugs first). If the plan decides you don't meet its criteria, you pay the full price, and none of it counts toward the cap unless you win an appeal.

Many of these requests are approved, but for an expensive specialty drug a denial can cost thousands of dollars. You can switch plans each fall, but a denial early in the year can mean months of costs with no cap.

Many folks use insurance brokers to help them choose Part D drug plans. Such brokers are knowledgeable and helpful but drug coverage is complex and constantly changing. Although I do not sell insurance products, I have built an online application to analyze drug plan formulary risks for high-probability conditions. This includes plans that have prior authorization roadblocks to certain drugs. If you want access to this tool, send me an email.

### **Medicare Choices Conclusion**

Medicare plan choices are complex. Missing a deadline or making the wrong choice for your situation can result in significant health risks and/or significant financial costs. Drug plans are particularly difficult to analyze for expensive uncovered drugs you might need in the future. Doing your homework on this at age 65 is important!

## **Long-Term Income Portfolio Strategy and Performance**

Berkeley Investment Advisors uses several different strategy portfolios to manage client assets. The Long-Term Income portfolio focuses on taxable intermediate to long-term-maturity bonds and preferred stocks. Normally, longer maturity bonds provide higher interest rates (yields) than shorter maturity bonds and are more sensitive to changes in interest rates. A bond's interest rate sensitivity risk, known as its duration, tells us how big a change in price we can expect when interest rates change. The duration of the portfolio is currently at 5.3 (it was 4.7 last year). If we held a bond with duration of 5 when rates went up 2%, we would expect the bond's price to decline by 10% (multiplying the rate increase by the duration).

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<sup>2</sup> However, a temporary Medicare program runs through 2027 and offers certain GLP-1 drugs for \$50 a month to people who meet weight and health criteria. It's separate from your plan, and those costs don't count toward the cap.

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Besides interest rate risk, there is also default risk in this portfolio. Bonds with higher probabilities of default (relative to other corporate bonds) compensate investors with higher interest payments – hence they are called “high yield” bonds. High yield bond default risk is like stock market risk - it is correlated with the performance of the economy. At the portfolio level we diversify away individual company default risk by diversifying across many issuers. This ensures that the extra premiums earned will not be lost due to a few companies defaulting. Our strategy is to accept market-correlated credit risks to earn those extra returns.

The extra return on high yield bonds over the interest rate paid by the U.S. Treasury is called a credit spread – it is the compensation that investors demand for taking credit risks. These spreads change according to investors’ risk preferences – i.e., how much they need to get paid for taking credit risk changes according to market mood just like stocks. Therefore, by accepting default risk we also accept credit spread “pricing risk” and we must endure fluctuations in our portfolio value that correspond to changes in the market mood – risk-seeking or risk aversion– but at roughly half the level of stock market moves. Because current spreads are low relative to historical norms, the portfolio has a lower-than-normal allocation to high yield securities.

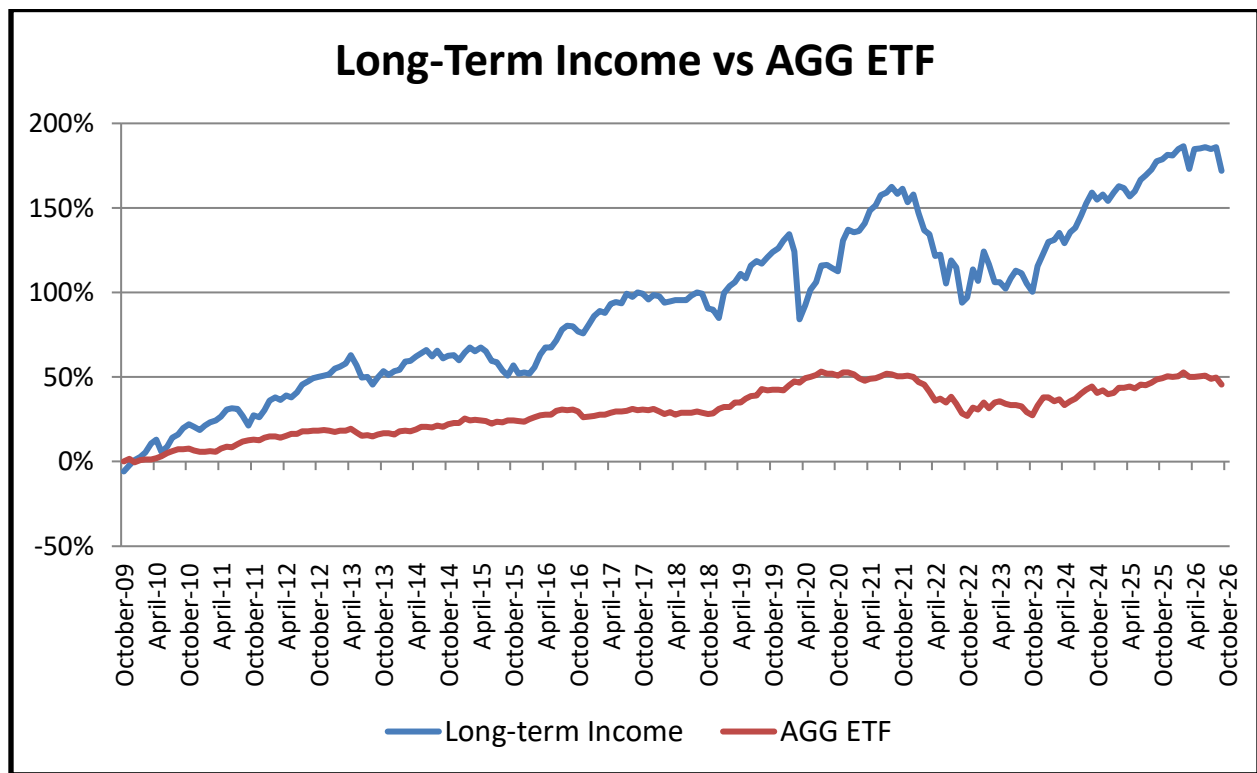
We generally earn incremental yield by buying closed-end funds (CEFs). These securities can usually be bought at discounts to the underlying bond values (and occasionally sold at a premium). These funds also enhance returns through embedded leverage. Using these securities means we must endure more price volatility in down markets because most retail investors want to sell more at lows. Current conditions are providing 0.4% additional yield on our portfolio compared to if we held the underlying bonds directly.

The Long-Term Income portfolio is diversified across virtually all sectors of the fixed income market, including government bonds and mortgage-backed securities. A good comparison index is the Barclays U.S. Aggregate Bond Index as represented by the iShares Core Total U.S. Bond Market exchange traded fund (ticker AGG). This is meant to represent the total overall U.S. bond market.

Our portfolio returns calculated here are based on a particular client’s account and have been reduced by annual fees of 1.25% which would apply to new accounts above \$500,000 but below \$1 million.

The graph and the table on the next page show total returns including price and interest payments in comparison to the bond index mentioned above, as implemented in the exchange traded fund (ticker AGG). Over the last year the portfolio loss was -2.0% compared to -1.9% for its bond index benchmark (AGG). The total return over 17 years was 172.1% - an annualized compound rate of return of 6.1%.

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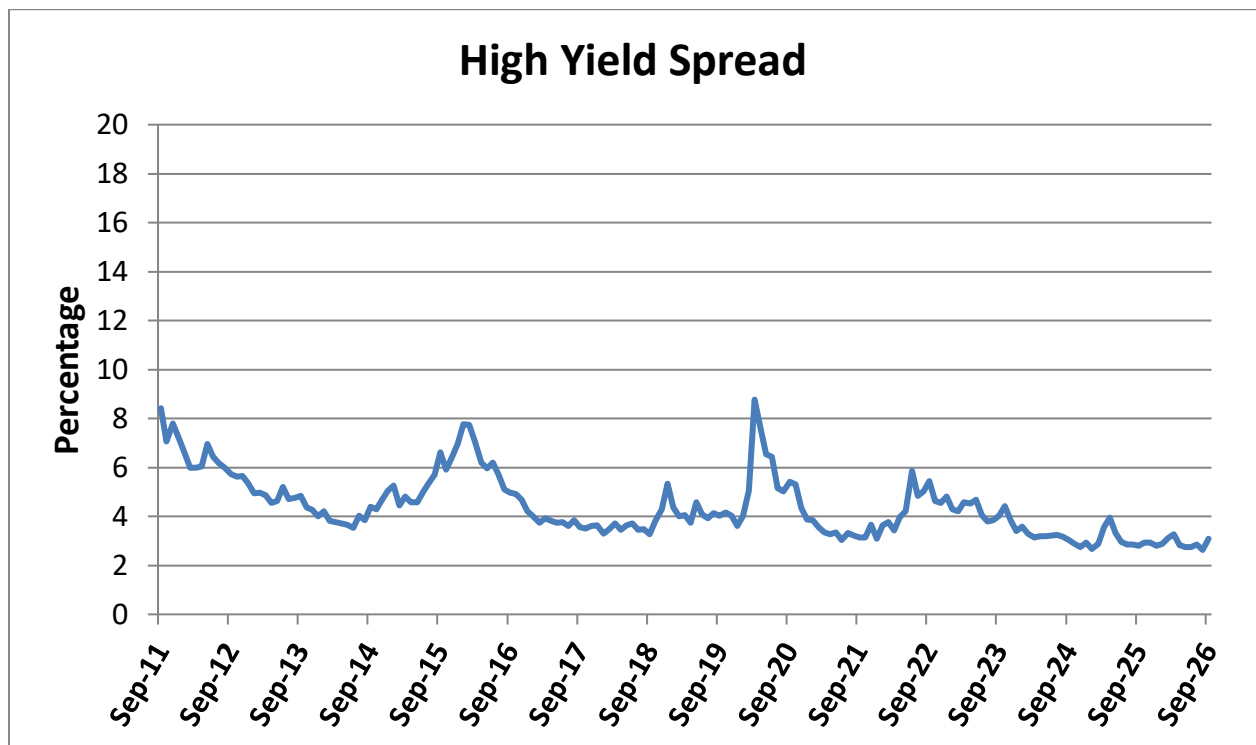
#### Returns by Year

| Year             | Year Ended | Long-Term<br>Income | AGG Bond<br>Index | Difference |
|------------------|------------|---------------------|-------------------|------------|
| 1                | 9/30/2010  | 19.8%               | 7.4%              | 12.4%      |
| 2                | 9/30/2011  | 1.2%                | 5.0%              | -3.8%      |
| 3                | 9/30/2012  | 23.1%               | 5.0%              | 18.1%      |
| 4                | 9/30/2013  | 0.2%                | -2.0%             | 2.3%       |
| 5                | 9/30/2014  | 7.6%                | 4.1%              | 3.5%       |
| 6                | 9/30/2015  | -6.4%               | 2.9%              | -9.3%      |
| 7                | 9/30/2016  | 19.4%               | 5.2%              | 14.2%      |
| 8                | 9/30/2017  | 11.3%               | -0.1%             | 11.4%      |
| 9                | 9/30/2018  | -0.5%               | -1.3%             | 0.8%       |
| 10               | 9/30/2019  | 10.9%               | 10.3%             | 0.6%       |
| 11               | 9/30/2020  | -2.9%               | 6.8%              | -9.8%      |
| 12               | 9/30/2021  | 20.5%               | -1.0%             | 21.4%      |
| 13               | 9/30/2022  | -24.9%              | -14.5%            | -10.4%     |
| 14               | 9/30/2023  | 5.8%                | 0.5%              | 5.2%       |
| 15               | 9/30/2024  | 26.3%               | 11.6%             | 14.7%      |
| 16               | 9/30/2025  | 7.1%                | 2.9%              | 4.2%       |
| 17               | 9/30/2026  | -2.0%               | -1.9%             | -0.1%      |
| Compounded Total |            | 172.1%              | 45.7%             | 126.3%     |

The Long-Term Income portfolio experienced a relatively large drop in value over the last month. This decline of 4.9% was large enough to put the portfolio into a loss position for the year ended 9/30/26, the first losing year since the huge run-up in interest rates in 2022. As I will explain below, this is due to the surprisingly large jump in Treasury yields above 5%, which in turn caused retail investors to sell closed end funds at much larger discounts than normal. Yields at these levels have not been seen since 2007 before the financial crisis.

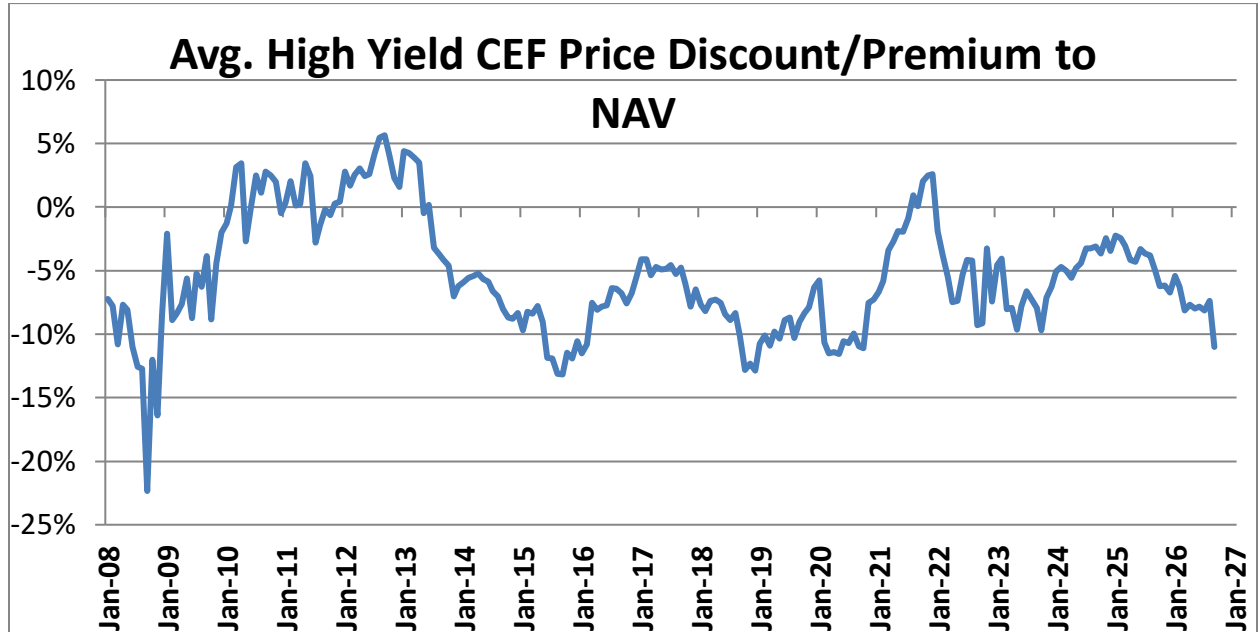
For the year ended 9/30/26 the interest rate on 10-year treasury bonds increased from 4.16% to 5.28%. I estimate that this interest rate increase decreased the market value of the portfolio by around 5.6% compared to last year (5.0 average duration times the 1.12% interest rate increase). Remember our portfolio value moves in the opposite direction of interest rates. This is a huge move in interest rates and 0.53% of it happened just in the last month.

The graph below shows credit spreads over the last 15 years. The median spread over this period is about 4.03% and spreads gyrate around this central tendency, driven by market sentiment. The current spread of 3.08% is 0.28% higher than last year. I estimate that the increase in credit spreads reduced portfolio value by approximately 1.4% compared to last year.



The portfolio's price returns (i.e., not counting interest payments) were also impacted by changes in CEF prices relative to the underlying bonds. To determine the impact, we can look at monthly prices and net asset values (NAVs) for some representative CEF holdings. NAV represents the value of underlying bonds inside the closed end funds and the difference between price and NAV is the discount that funds trade at relative to value.

To get an idea of how much CEF discounts can vary, I pulled data on a group of 8 CEFs with data available back to the beginning of 2008. See the graph below. These CEFs have been included in either the Long-Term Income portfolio or the Short-Term Income portfolio.



The chart above shows the average discount for these 8 CEFs at the end of each month. We see that the current average of discounts, 11%, is the largest since 2020; they exceed the October 2023 discounts we saw the last time the 10-year Treasury yield touched 5%. The actual average discount in the portfolio increased from 2.3% last year to 10.2% this year; part of this comes from portfolio changes.

Given the large increases in Treasury yields, credit spreads, and CEF discounts over the last year, I consider the small loss on the portfolio amazing. Because the changes in Treasury rates and CEF discounts were so large, it is likely we won't see such large changes going forward. At 9/30/26, the underlying yield on the funds in the Long-Term Income portfolio is 8.11% (before fees). From these levels, the portfolio offers acceptable expected returns for this market environment.

## Real Estate Portfolio Strategy and Performance

The Real Estate portfolio was launched August 31, 2020 based on my expectations for a surge of inflation resulting from the pandemic's impact on production, and the government's large handouts designed to stimulate demand. In order to provide an investment protected against higher inflation, the portfolio is allocated 39% to residential REITs, 31% to self-storage REITs, 16% to Gold, and the remainder invested opportunistically in other real estate securities and inflation protected bond funds.

The results for the first year of this portfolio were spectacular. The total return, including dividends, capital gains, and price appreciation, was 55.7%. In 2022 it fell as the Federal Reserve pushed up inflation adjusted (i.e. real) interest rates.

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The rapid run-up in rents for apartments slowed considerably in 2023. Low interest rates in 2020 and 2021 spurred a large increase in apartment construction. Deliveries in 2023 and 2024 depressed rent growth. The decline in rent growth has dampened dividend growth and investors have responded by bidding down REIT prices to compensate for lower growth. Consequently, returns have been disappointing. The annualized return over the 6-year life of the portfolio has been 6.1% after deducting annual fees of 1.25% which would apply to new accounts above \$500,000 but below \$1 million.

In 2026 rising interest rates are again hurting the value of this portfolio. The return over the last year to 8/31/26 was 3.1%. On the positive side, given the current low valuation of this portfolio, its downside risk is relatively low. Currently this portfolio provides a dividend yield of 4.4% and most of that income gets favorable tax treatment as Qualified Business Income.

So long as the Federal Reserve keeps its independence and no new massive government stimulus packages are approved, I would not expect rent inflation to drive abnormally high returns on this portfolio. Consequently, I expect future returns in the range of 5-8%. Given the current unfavorable market environment, with interest rates moving up significantly, I have reduced allocations to the Real Estate portfolio in favor of the Quantitative Equity strategy.

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