

QUARTERLY REVIEW

September 30, 2025

Q3 Economic and Market Commentary

In the third quarter of 2025 the market continued its relentless move upward with the S&P posting a gain of 8.1%, bringing the YTD return to 14.8%. The index is now up over 34% from its low of April 8th and the height of tariff uncertainty. In Q3 tariffs and the Fed were the two primary subjects that garnered investors' attention. Tariffs were top of mind to begin the quarter as the end of the 90-day reciprocal tariff extension was set to expire on July 9th. This in turn was extended to August 1, keeping both uncertainties as to final outcomes as well as actual impacts delayed. During that time major trade deals with the EU and Japan were completed. Once all is said and done, consensus expects tariffs to settle at a roughly 14% rate. As broadly anticipated, the Fed cut interest rates by 25 basis points on September 17th, yet interest rates which had moved lower prior to the actual cut, moved higher after the announcement was official. The evolving weakness in the labor market prompted the Fed to cut, even with the market at all-time highs, and inflation metrics moving slightly higher. One reason for the market strength was corporate earnings, which came in better than expected for the second quarter (no real impact on profit margins yet from tariffs), as earnings grew by 12% versus their expected increase of just 4.8%. While some tariff impact with certain companies can be quantified, most continue to show limited impact at present. Inflation increased marginally in the quarter with Core PCE now standing at 2.9% year over year. International markets were up 4.8% and are now up 26% YTD, eclipsing US returns for the first time in years, aided by a weaker US dollar. Gold continued higher reaching \$3840 as investors stockpiled holdings, most likely reflecting a lack of confidence in government deficits, the US dollar and worries about future inflation. The US dollar has remained weak and is down almost 10% YTD, which has aided US companies with international sales. If the Fed continues with further rate cuts by year end this could put additional pressure on the dollar.

The Economy

The US economy was solid with the final reading for Q2 GDP showing a strong gain of 3.8%, reversing the Q1 GDP drop of -0.6%. A decrease in imports helped to boost growth but the consumer continued to prove resilient with consumer spending, surging to an annualized rate of 2.5%. Tariffs could be influencing that number as consumers try to get ahead of perceived higher prices later in the year or in anticipation of a shortage of goods. The most worrisome factor that developed in Q2 was the slowing in the US labor market. The Bureau of Labor Statistics released its benchmark revision on September 9th which showed a downward adjustment of 911,000 jobs created between April 2024 and March 2025. While the bulk of the revisions cover the calendar year 2024, it suggests a labor market that produced on average 76,000 jobs less per month than originally reported (average gains of 70,000 versus 147,000). The month of June 2025 produced the first negative month for jobs since 2020 with a loss of 13,000 jobs. The situation improved a bit with July producing 79,000 jobs and August 22,000, for a 3-month average of just under 30,000 jobs. The current government shutdown will delay the September jobs report, forcing us to rely more on the ADP Employment Report which only includes the private sector. The just released September report showed the economy losing 32,000 jobs and revised lower the August report from a gain of 54,000 jobs to a loss of 3,000 jobs. Should this trend persist, we could start to see some cracks in the consumer, which could subsequently start to impact growth. Consumer confidence has weakened with September falling to 94.2, which is the lowest reading since April's peak tariff worries. However, the current expectation is that Q3 GDP will post another solid showing with the Atlanta Fed GDP Now forecast at 3.8%. With midterm elections in 2026 we expect the administration to run the economy "hot". The "One Big Beautiful Bill" will add about \$150 billion of Federal Tax refunds in early 2026 (\$517B vs \$359B in 2025) which could aid the consumer in a slowing job market. The corporate side also benefits and to date the amount of tax savings companies have received (\$108 billion mostly from R&D immediate expensing) has in effect sterilized the negative impact of \$96 billion of tariff collections. Further Fed easing should also help to ensure that the economy remains in solid condition, with current Fed Funds futures expecting a total of five additional rate cuts by year end 2026. We repeat this often, but the US economy doesn't go into recession when corporate earnings are growing, and that should continue to be the case in 2026.

Market Review

Third Quarter Market Recap:

The market closed Q3 just below its all-time high reached on September 22nd. The market was again led by the AI Centric Communications Services and Technology sectors which had gains of 12.6% and 12.2%, respectively. Capital spending for chips and data centers continues unabated with Amazon, Google, Microsoft, and Meta now expected to spend \$291 billion of capex representing 30% of the entire S&P 500 capex. This is benefiting the semiconductor stocks as well as power related infrastructure as data centers are huge consumers of electricity. In the semiconductor space Broadcom rose 19.9% in Q3, memory chip maker Micron gained 35%, and Nvidia added another 18%. Apple posted a comeback in Q3 jumping 24% as China sales showed some improvement and excitement over the new iPhone release proved stronger, however the stock is still lagging the market YTD at a +2% return. Within Communication Services Google rose 38% in the quarter on the back of good antitrust news with the court ruling that divestiture of Chrome was not required, as well as a solid Q2 earnings report that showed revenue growing 14%. Defensive sectors once again lagged as the market continued with a distinct “risk on” character. Consumer Staples fell 2.6% and are now up 3.9% YTD. This is a group that is experiencing higher costs due to tariffs (i.e., Proctor & Gamble +\$800 million), and while they are passing some or most on to consumers, there is risk that higher prices will impact demand. Healthcare was also weak in Q3 at +1.3% driven by a host of issues including possible drug price controls, ACA subsidies expiring, tariffs, and Medicaid spending reductions. While those concerns have had a notable impact on returns, the news in recent days that pharma companies that actively build manufacturing facilities in the US will receive an exemption from tariffs has resulted in a sharp upward move in the group since late September. We always prefer to see a broader market with more companies and sectors participating in returns, and this had been the case in the first half of 2025. In Q3 however the large mega caps again asserted themselves, with the capitalization weighted index outperforming the equal weighted S&P by 3.3%.

Stock Market Indexes

Market/Index	2024 Close	9/30 Close	Quarter Change Total Return	YTD Change Total Return
DJIA	42544.22	46397.89	5.67%	10.47%
Nasdaq	19310.79	22660.01	11.43%	17.96%
S&P 500	5881.63	6688.46	8.11%	14.81%
Russell 2000	2230.16	2436.48	12.39%	10.38%
IEFA	70.28	87.31	4.59%	26.46%

What to Expect Going Forward:

Wednesday, October 8th marked the 125th trading day off the April low, and as it stands this is the market's fourth strongest rally historically off a correction of at least 15% going all the way back to 1956. With history as a guide, the recovery rally usually does not stop here but normally continues for another 3 – 6 months averaging additional gains of 8 – 10%. We would file this in the “good to know” category, but probably optimistic in terms of the magnitude of further gains over another quarter or two simply due to valuation metrics. This is a broken record, but market valuations are high and have been so for some time. The forward 12-month P/E is 22.5X (10-year average is 18.6X), with the top five stocks sporting a 30.6X multiple, and the S&P median stock at 19.4X. Fortunately, earnings have come in better than forecasted, helping to maintain valuation levels. The environment for stocks is likely to remain positive in that both fiscal and monetary stimulus is on the horizon, and earnings forecasts for 2026 are strong with 13.8% growth expected. We are also entering a seasonally strong period for the market as Q4 returns since 1950 have averaged +4.1%. Could this holiday season disappoint with the job market slowing and perhaps higher prices? Current forecasts are for holiday spending to grow roughly 3.5% y/y. We remain concerned about margin deterioration as current 2026 earnings forecasts are predicated on record operating margins of 18.3%. Should inflation surprise to the upside, margins would not be as strong resulting in weaker than predicted earnings growth. There is some wiggle room implicit here however as sales growth year over year has been outpacing cost growth indicating the ability for now to pass along higher costs to not only protect profit margins but also to expand margins. The biggest risk for both the economy and the markets at this juncture in our opinion is inflation. The Core CPI has shown a rising trend over the past 3 months running at an annual rate of 3.65% versus the previous 3 months at 2.7%. The Core CPI year over year is currently at 3.1% and was higher than estimates. Core PCE, which the Fed prefers, has shown a more stable monthly change and is presently at +2.9% year over year, but clearly still far away from the 2% target. When we couple these numbers with the M2 Money Supply growing at a 3-year high of 4.8%, this indicates an easing in the monetary conditions and bears careful attention as it tends to be a good leading indicator for future inflation. Persistently rising inflation would likely crimp consumer demand, impact corporate profit margins, and result in the Fed having to slow or abandon the expected number of rate cuts in this cycle. Stock valuations would also likely suffer if it were perceived that inflation is not contained, so the trajectory of inflation is what will command our attention in coming weeks and months.

Fixed Income Recap and Outlook

The most significant development in the Q3 was the down shift in employment growth from running ~140,000 new jobs per month, to 70,000 after the BLS adjustment in September which subtracted 911,000 for the 12 months between March 2024-March 2025. Other job metrics such as the unemployment rate, jobless claims and the JOLTS data are consistent with a stable job market which is now being characterized as “slow to hire, slow to fire.” With concerns about the potential for a weakening job market, the Fed took the opportunity to make an “insurance cut” by lowering the overnight rate from 4.25%-4.5% to 4%-4.25%, its first cut since December 2024.

Inflation, however, remains elevated to the Fed’s desired goal of 2%, as measured by both the CPI and PCE stuck in the 2.5% to 3% range. Despite this, the Fed has articulated that it believes inflation, while elevated, will not increase broadly due to the implementation of tariffs.

Treasury rates moved lower over the quarter in anticipation of even more Fed rate cuts. At the end of September, the market is pricing in more cuts through 2026 for a terminal rate of 3%. Other parts of the fixed income market shrugged off the weaker jobs number and uncertain economic outlook. Risk spreads across the fixed income quality spectrum moved lower during the quarter reflecting the continued demand from investors for yield. Investment grade credit spreads tightened to 30-year lows showing investors have no near-term concerns with a weakening economy and/or deteriorating corporate balance sheets. High yield has also performed very well with that market not pricing in any imminent spike in defaults from lower rated companies.

Performance was solid across the fixed income universe as broad market indicis returned between 1.5% and 2.03% in Q3. Longer dated securities returned more than shorter duration securities with the long US Treasuries returning 2.49% and intermediate US Treasuries returning 1.26%. In August, long Treasuries were actually underperforming due to concerns about deficits and Fed independence but in September, this reversed and yields ended the quarter slightly lower. All risk sectors outperformed US Treasuries due to their extra yield as well as due to spread tightening. Corporate bonds returned 2.6%, outperforming similar duration US Treasuries by 98bps and Agency MBS returned 2.43% in the quarter, outperforming by 83bps. Lower rated investment grade modestly outperformed higher rated investment grade as Baa securities returned 2.71% vs A rated securities returning 2.52%. The Tax-Exempt market was also strong as the attractive after-tax yield brought in investors. For the Quarter the overall Municipal Bond Index returned 3% and longer municipals performed better returning 3.8%

