



2025 FALL INVESTMENT OUTLOOK

The first half of this year was marked by significant volatility in the stock market and as we transitioned into the fall months, the market stabilized and continued its upward trend, achieving new record highs along the way. Investor sentiment remains optimistic as evidenced by historically low cash levels held by fund managers and a market rally that has broadened beyond the large cap technology sector in recent months. Equity valuations have returned to elevated levels last seen at the prior market peak in 2021 in part due to strong corporate earnings growth and the expectation of two additional rate cuts by the Federal Reserve by year end.

The market rally that began in April due to easing trade tensions has continued in part due to strong corporate earnings that have grown at a double-digit rate for three consecutive quarters. Investor sentiment also benefited from the passage of the “One Big Beautiful Bill”, which permanently extended corporate tax cuts from 2017 and introduced additional tax provisions that directly benefit corporate profitability. The announcements of “framework agreements” with Japan and the European Union has further alleviated concerns about a protracted trade war with our largest trading partners. The administration has also worked closely with the largest technology companies to reduce regulatory burdens, particularly those imposed by foreign countries.

While the clarity provided by the announced agreements with our trading partners has been welcomed by Wall Street, baseline tariffs have begun to put upward pressure on inflation. The Fed’s preferred inflationary gauge of core PCE has steadily moved up from 2.7% in January to the latest reading of 2.90% in August. This accelerating pace of inflation has coincided with a notable slowdown in the labor market over the past three months. The last three labor reports have averaged just 29,000 payroll gains after averaging 175,000 additions per month through April. The unemployment rate has ticked up to 4.3%, the highest since 2021, and June’s revised payroll numbers showed a loss of 13,000 jobs, the first monthly jobs loss since December 2020. GDP growth estimates have ticked up slightly from the summer but remain meaningfully below expectations of 2%+ GDP growth at the beginning of the year. Despite elevated levels of inflation, the Fed has signaled rate cuts due to concerns related to the employment outlook.

For now, Wall Street has chosen to focus on the stimulative effects of easier monetary policy rather than the risks posed by a softening macroeconomic environment and an uncertain geopolitical backdrop. Investors are encouraged by resilient consumer spending, above average corporate earnings growth and the anticipated benefits of artificial intelligence. The prospect of interest rate cuts has stoked demand for corporate credit with spreads narrowing to the lowest since 1998. High yield corporate bond issuance has surged due to strong investor demand and the S&P 500 has rallied 32% from the bottom in April. Year-to-date returns for some of the most popular market indices are noted below:

Equity Markets – 9/19/25

	<u>Index Price Level</u>	<u>2025 YTD Total Return</u>
Dow 30 Industrials	46,315	+10.3%
S&P 500	6,664	+14.6%
NASDAQ Composite	22,631	+18.1%
MSCI All Country World Index ex-USA	1,056	+26.0%

The S&P 500 Index is a market capitalization-weighted index of 500 large capitalization stocks commonly used to represent the US equity market.

The Dow 30 Industrial Index is a price-weighted index of 30 US blue-chip companies.

The NASDAQ Composite Index is a market capitalization-weighted index of over 2,500 companies listed on The NASDAQ Stock Market.

The MSCI ACWI ex USA Index is a market capitalization-weighted index representative of developed and emerging market stocks excluding the US.

Outlook

Despite the increased uncertainty surrounding the employment outlook, economic growth expectations remain stable with Bloomberg consensus calling for GDP growth of 1.7% this year and next. These expectations remain subject to meaningful revisions should the employment figures continue to deteriorate. The latest data point reported showed initial jobless claims, an indicator for layoffs, rising to 263,000, the highest level since October 2021. US economic growth remains heavily dependent on consumer spending, which is expected to decelerate to a 1.1% growth rate in the second half of this year from an average of 2.8% over the previous three years. While strong retail sales data is indicative of a resilient consumer, some credit indicators are showing signs of stress. Delinquency rates on consumer debt have risen to the highest level since early 2020 in part due to a record increase in past due student loans. Financial stress is starting to affect even high income consumers, which account for 49.2% of total spending. Delinquencies on credit card and auto loans are rising fastest for borrowers making at least \$150,000 annually. However, the wealth effect from a strong stock market along with new deductions from President Trump's One Big Beautiful Bill could serve as tailwinds for consumer spending power. Economic growth should also benefit from the bill's permanent deduction for R&D which is expected to provide a boost to corporate investment.

Despite the benefit of a record high stock market and near record low unemployment, consumer sentiment is 35% below the historical average as measured by the University of Michigan. The conference board's expectations index has been in recessionary territory for nearly two years. While there are many factors that impact consumer confidence, rising inflation expectations remains a consistent theme. Consumer expectations of long-term inflation have moved up to 3.9% in September, the highest level since the spring of 2022. As the impact of tariffs flows through to consumer prices, the risk of inflation becoming entrenched in consumers' minds has increased. This dynamic has complicated the Fed's job of balancing employment and price stability. In recent months, the Fed has become more concerned about cracks forming in the labor market than it is about persistently high inflation. As a result, the Fed lowered its benchmark interest rate by 25 basis points to a range between 4.0% and 4.25%. The majority of Fed officials penciled in at least two additional cuts this year, implying a range between 3.50% and 3.75% by year-end. The Fed expects the inflationary impact of tariffs to be transitory, with projections of 2.6% inflation next year and 2.1% in 2027.

Chairman Powell has acknowledged that the risk of a policy miscalculation has increased due to the tension between the Fed's two goals; balancing the need to control persistent inflation against clear signs of a cooling labor market. This challenge is further complicated by uncertainty in the interpretation of payroll data. Due to recent shifts in immigration policy, the historical benchmark of 130,000 new jobs per month may no longer be a valid measure of a balanced jobs market; a significantly lower figure may now be

sufficient. Easing monetary policy to support a labor market that appears weak by historical standards may inadvertently overheat it and reignite wage inflation. This challenging dynamic has resulted in a wide dispersion of views among Fed officials on the appropriate path for interest rates. The Fed's collective guidance of two additional rate cuts this year is informed in part by its history of being too slow to react to emerging risks to economic stability. However, its policy is not on a preset course and could change if the economy evolves differently than expected.

Despite the Fed cutting interest rates by 75 basis points over the last year, long-term Treasury yields have risen with the 10-year and 30-year Treasury yields increasing by 42 basis points and 66 basis points respectively. The Fed has been successful in lowering short-term Treasury yields however, borrowing costs for consumers and businesses remain elevated because most financial products such as mortgage rates are priced off the yield on the 10-year note. While it is hard to pinpoint the exact reason for elevated long-term yields, it is likely due to some combination of sticky inflation, rising fiscal deficits and geopolitical and policy uncertainty.

Congress is expected to raise the budget ceiling again this month with the annual deficit expected to total \$1.8 trillion for the 2025 fiscal year. The One Big Beautiful Bill is expected to be stimulative for economic growth over the short to medium term. However, the non-partisan Congressional Budget Office estimates that the law will increase budget deficits by \$4.1 trillion over the next ten years. The US is not the only country experiencing higher borrowing costs due to widening budget deficits. The yield on the UK's 30-year bonds have reached the highest since 1998 and Japanese 20-year notes have climbed to the highest this century. The yield on a Bloomberg index of global sovereign bonds maturing in 10 years and longer reached the highest since 2009. Investors globally have become increasingly concerned about inflation, rising debt levels and poor fiscal discipline.

Another potential factor underpinning the stubbornness of the 30-year yield may reflect a growing risk premium associated with heightened political scrutiny of monetary policy. The current discourse surrounding the Fed's operational autonomy has introduced a new variable for bond investors. However, the current discourse is not without historical precedent. The Fed successfully resisted pressure from the Johnson administration to ease monetary policy in the 1960's. A similar episode in the 1970's provides a cautionary tale when the Nixon administration successfully influenced the Fed into keeping loose monetary policy, which eventually contributed to a surge in inflation and a spike in bond yields.

Perhaps the clearest signal of market concern related to these tail risks is evident in the price of gold, which has surged by 40% this year. The current dynamic of both the stock market and gold simultaneously achieving all-time highs has historical parallels to the transition period of the late 60's and 70's. Today, as in that era, a combination of large fiscal deficits, persistent inflation, and heightened geopolitical friction is driving a global trend of central bank diversification away from the dollar into gold. The current market's focus on the separation of monetary policy from other government objectives also appears to be fueling the demand for gold as a hedge against policy miscalculation, a dynamic with specific echoes of the early 1970s.

For the time being, the market has largely taken these tail risks in stride. Corporate credit spreads have compressed to decade lows and the current S&P 500 forward price-to-earnings ratio of 23x has only been exceeded by the peak of the dot-com bubble in 2000. Investor sentiment is sanguine and household allocation to stocks is at a record high of 45.4%, three percentage points above the 2021 record and seven points above the 2000 dot-com bubble peak. Barclay's Equity Euphoria Indicator, a measure of investor excitement derived from options data, has reached levels not seen since 2021 and 2001. This aligns with

recent signs of speculative behavior such as the return of meme stocks and the rise of crypto treasury companies.

The trend of the largest seven companies driving a disproportionate share of the S&P 500 Index returns has continued to date. Although these companies trade at a valuation of 30x forward earnings compared to 20x for the rest of the index, this premium reflects their superior earnings growth. Over the last decade, their earnings have grown at a compounded annual growth rate of 35%, significantly outpacing the 5.6% growth rate for the remaining companies. The bigger risk lies in the index's outsized exposure to the technology industry which has been buoyed by the excitement around artificial intelligence. AI related capital expenditures contributed 1.1% to GDP growth in the first half of 2025, outpacing the U.S. consumer's contribution to GDP growth. The current pace of investment appears remarkably similar to the investment boom in telecommunications infrastructure which peaked at approximately 1.1% to 1.2% of US GDP in 2000. While these dominant technology companies are the beneficiaries of the current enthusiasm for artificial intelligence, they face a shared risk. Should this excitement turn into disappointment, these seven companies may be punished collectively irrespective of the strength of their underlying fundamentals.

Investment Conclusion

Although there appears to be a disconnect between the performance of the stock market and elevated levels of geopolitical and macroeconomic uncertainty, it is important to remember that the stock market is not synonymous with the economy. The US remains a haven during uncertain times and is home to the most innovative companies in the world. While the current market environment has displayed concerning signs of speculation, our focus remains centered on prudent risk management and identifying opportunities for superior risk-adjusted returns across multiple economic cycles. This approach has enabled us to trim our exposure to holdings that have moved substantially above their fundamental value and capitalize on opportunities created by market uncertainty to invest in companies that we believe can deliver above average returns over the long-term. We continue to invest in select corporate bonds and Treasuries, however, the Fed's recent shift towards future interest rate cuts has made these options slightly less attractive than they were earlier this year. Investors are advised to keep extra cash on hand as the current combination of economic uncertainties and elevated valuations have resulted in scant opportunities to buy quality businesses at reasonable valuations. Our long-time horizon remains the bedrock of our investment process and our guiding principle remains focused on helping our clients grow wealth in a way that can deliver lasting value.

September 22, 2025