

Q4 2025 Market Update: Managing Mixed Economic Indicators



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Market fluctuations are an inherent aspect of the investment landscape, and 2025 has proven no different despite positive year to date returns in almost every category. Fluctuations in the market—including sell-offs triggered by trade policy concerns—may cause discomfort, but do not forget these are also opportunities to purchase quality assets at lower prices. Conversely, when markets rebound and achieve new peaks (such as now), it's normal to experience apprehension despite solid fundamental performance.

In either case, we believe for the long term investor it's not wise to try to time or predict the "top" or the "peak" as more times than not investors get it wrong. History proves that in the longer term investors win more predictably staying fully invested even in an expensive bull market (which is what I would argue we are in now).

It's critical to maintain diversified but thoughtfully allocated portfolios now more than ever. On that note, it's why we shifted some of our focus from larger companies to high quality but not as richly valued small and mid sized companies at the beginning of last quarter. We made this change due to a more stable to slightly declining interest rate environment coupled with lower valuations in those investment categories.

Notable Market and Economic Developments in Q3

- During the third quarter, the S&P 500, Nasdaq, and Dow Jones Industrial Average advanced 7.8%, 11.2%, and 5.2%, respectively, with all three indices establishing new peaks in September. For the year through September, these indices have gained 13.7%, 17.3%, and 9.1%.
- The Bloomberg U.S. Aggregate Bond Index posted a 2.0% quarterly gain and has risen 6.1% year-to-date. The 10-year Treasury yield closed the quarter at 4.15% after touching 4.02% in September.
- International developed market equities (MSCI EAFE) climbed 4.2% while emerging market equities (MSCI EM) surged 10.1% during the quarter.

- The U.S. Dollar Index declined to 96.63 in September before finishing at 97.78 for the quarter. Year-to-date, the dollar has weakened 9.9%.
- The Consumer Price Index rose 2.9% in August while core CPI increased 3.1%.
- According to the Bureau of Labor Statistics' most recent report, just 22,000 net new positions were added in August. Since May, monthly job creation has averaged merely 26,800.
- During its September meeting, the Federal Reserve reduced rates by 0.25% to a 4% to 4.25% range.

Market valuations approaching historical extremes



For investors with extended time horizons, understanding overall market valuation levels represents a crucial consideration. Rather than concentrating solely on market prices, valuations reveal what investors receive for those prices regarding earnings, cash generation, revenues, dividend payments, and additional corporate metrics. Elevated valuations indicate investor optimism but may also suggest overly ambitious expectations in certain market segments.

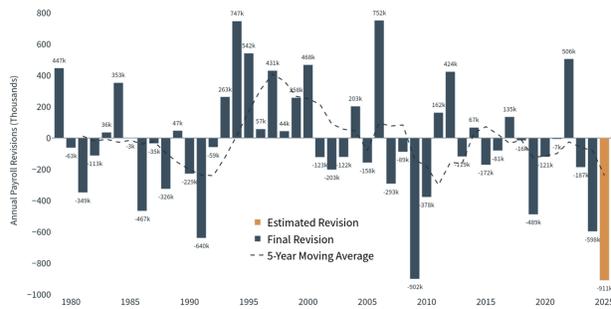
Current valuation levels should come as no surprise following the substantial rally over the previous two quarters. Since April 8, the S&P 500 has surged 34%, producing double-digit annual returns. Technology stocks spanning multiple sectors have paced the market's ascent, just as they led the prior decline. The Magnificent 7 stocks, for example, have jumped 61% from the trough. Although investors increasingly debate whether corporate artificial intelligence investments will yield positive returns, these expenditures have undeniably driven broader market performance and business capital allocation.

Valuations should not be interpreted as predictors of near-term market direction or utilized as market timing instruments. Rather, they function as essential components of the asset allocation framework. While overall market valuations appear stretched, this characterization does not apply uniformly. Small-cap stocks, value-oriented equities, and international markets currently trade at more reasonable valuations compared to large-cap, growth-focused, and domestic stocks. This is exactly why we have significant exposure in your portfolios to each of those categories and in fact we shifted a small portion from large cap stocks into mid and small cap stocks as part of our mid-year investment changes.

Federal Reserve reduces rates as employment weakens

Annual Payroll Revisions

Preliminary and final payroll revisions from the Bureau of Labor Statistics



Sources: Clearnomics, Bureau of Labor Statistics
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In September 2025, the Federal Reserve lowered interest rates by 0.25%, continuing its accommodation cycle after maintaining steady rates throughout much of the year. This move reflects the central bank's efforts to navigate persistent inflation exceeding the 2% objective while addressing labor market deterioration. Markets had broadly anticipated this reduction, which has provided support in recent months.

Several factors distinguish this rate reduction cycle. Traditionally, the Fed has lowered rates in response to economic crises or recessions. Although certain

weakness indicators exist today, overall economic expansion remains healthy. Consequently, recent cuts represent something distinct: an effort to restore normal policy settings following the aggressive tightening campaign initiated in 2022. This explains why the Fed is easing policy despite ongoing economic expansion and markets trading at record levels.

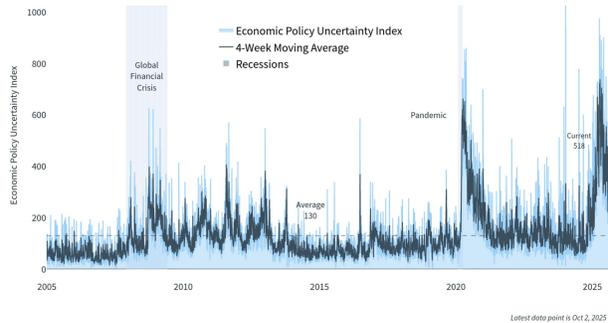
Labor market deterioration has emerged as perhaps the most significant factor influencing the Fed's actions. Though the 4.3% unemployment rate remains historically low, job creation has decelerated sharply. August witnessed just 22,000 new payroll additions, substantially below the 123,000 monthly average recorded earlier in the year.

Accordingly, the Fed is reducing rates because, per the latest FOMC statement, it "judges that downside risks to employment have risen." For investors, rate reductions generally benefit both equity and fixed income markets when economic conditions remain solid.

Volatility and policy uncertainty temporarily subdued

Economic Policy Uncertainty

Uncertainty based on news, taxes, and forecaster disagreement
Index of 100 represents the average from 1985 to 2009



Latest data point is Oct 2, 2025

Sources: Clearnomics,
Baker, Bloom, and Davis,
Federal Reserve
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Following substantial volatility stemming from trade policy and fiscal concerns earlier this year, indicators of economic policy uncertainty have moderated. The VIX index measuring stock market volatility currently sits around 16.3, beneath the long-term average of 18, while the MOVE index tracking bond market volatility has fallen to 78, below the 87 average.

Experienced investors understand that tranquil market periods can shift rapidly. Recent years have witnessed numerous volatility episodes stemming from inflation, trade disputes, policy developments in Washington, Federal Reserve actions,

recession concerns, geopolitical tensions, and additional factors. The ongoing government shutdown represents merely the latest event with potential to disrupt markets short-term, even if long-term implications prove limited. Similarly, outcomes of trade policies and inflationary impacts remain unclear.

For investors, this uncertainty may generate discomfort, yet it also shapes long-term portfolio results. Recent years have illustrated the divergence between investor concerns and actual market performance. Rather than treating uncertainty as something to circumvent, successful long-term investors recognize it as an inherent market characteristic that creates opportunities to position portfolios for future years.

The bottom line? As the year's final quarter commences, markets stand near record highs while economic signals remain mixed. This landscape reinforces the necessity of maintaining proper asset allocation and concentrating on long-term financial objectives.

As always, reach out to us if you want to discuss any of this more or if any your goals or time horizon has shifted.

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