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Mitch on the Markets

Portfolio Manager Investing Insights

4 Risks Investors Should Watch for in Q4

Barring a sharp correction in the next few trading sessions, U.S. stocks are likely heading into the fourth quarter near all-time highs. I've made the case previously that steady, although fairly modest, economic growth paired with resilient earnings has supported prices to date. With the Federal Reserve poised to ease monetary policy as the economy expands, there is not a great case for being outright bearish.[1]

But that does not mean risks are low. Below, I outline four that I think investors should be keenly watching in the next quarter and beyond.

Risk #1: A Second Wave of Inflation

Among institutional investors, recession fears dominated earlier this year, particularly following the "Liberation Day" announcement. Today, it's inflation that is again the top concern. August CPI data underscored this concern, with inflation coming in hotter-than-expected. The risk here is that the Fed will again have to reverse course, just as the market is baking in expectations for several rate cuts.

Prices for some goods may rise, especially where tariffs hit. But without the monetary backdrop to sustain a broad-based surge, the specter of *runaway* inflation looks overstated, in my view. Broad money supply growth in the U.S. remains tame (see M2 money supply chart below), though the trend line will be worth watching closely in the months ahead.

Source: Federal Reserve Bank of St. Louis[2]

ABOUT MITCH ZACKS

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Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

Risk #2: Concern Over Federal Reserve Independence and U.S. Dollar Weakness

Fed policy is always political to some degree, given that appointments come from the White House and confirmations from the Senate. Removing Fed governors because of a disagreement over policy would be a major concern, but the Supreme Court already reaffirmed this year that such an act would be illegal. Public criticism of rate policy may seem threatening, but it's also nothing new, and there is little evidence it has swayed decision-making from the Federal Open Markets Committee.

As for the dollar, "de-dollarization" chatter resurfaces regularly, with Russia, China, or the BRICS bloc often floated as challengers. Yet data show the dollar still comprises more than half of global currency reserves, and it is involved in nearly 90% of all foreign exchange transactions. No other currency matches the U.S. dollar's liquidity, stability, and global reach. Over time, the dollar's share may fluctuate, but fears of sudden debasement or collapse look misplaced.

Risk #3: Over-Concentration

Tech remains the market's favorite sector, with AI-related companies driving much of 2025's gains. In my view, this enthusiasm reflects strong fundamentals. Q3 2025 Tech earnings are expected to rise over 12% year-over-year on similarly strong revenue growth.

But with enthusiasm comes concentration. When too much capital chases the same trade, markets become vulnerable to abrupt reversals if sentiment shifts. For now, earnings support remains solid, but this is a reminder of the importance of diversification. Overcrowding isn't a reason to avoid strong companies, but it does raise the odds of volatility if momentum cools.

Risk #4: Rising Long-Term Bond Yields

The summer saw 30-year yields in the U.S., U.K., France, and Germany climb to multi-year highs, sparking a wave of debt-crisis headlines. In Britain, rising gilt yields were pinned on budget concerns. In France, an offhand remark about an IMF bailout got blown out of proportion. In the U.S., some tied higher yields to worries about refunding tariffs should courts strike them down.

But a closer look reveals that rising long yields is a global issue. Italy, Spain, Canada, and Australia all saw long-term yields rise in tandem. In my view, and as I've written before, this trend is less about country-specific fiscal woes and more about sentiment flowing through interconnected global bond markets. Historically, modest increases in long rates alongside central bank rate cuts steepen yield curves, which is a setup that can support lending and growth.

Bottom Line for Investors

It's a mixed bag right now for investors. Many are growing more bullish as 2025 closes, but worries also remain. Inflation, Fed independence, dollar stability, crowded trades, and rising yields all top the list. But it's also true that these risks are widely known and widely discussed, which in my view reduces their power to derail the bull market.

For long-term investors, the persistence of these worries ultimately creates a constructive backdrop. Earnings continue to hold up, the Fed has begun easing, and the economy is chugging along despite headwinds. Volatility may flare if one of these worries dominates headlines again, or if the risk comes to fruition in a worse way than expected. That's why I'm urging investors to stay focused on them.

[1] TrustNet. September 16, 2025. https://www.trustnet.com/news/13458457/fund-managers-pile-into-tech-stocks-despite-record-overvaluation-fears

[2] Fred Economic Data. September 23, 2025. https://fred.stlouisfed.org/series/WM2NS#

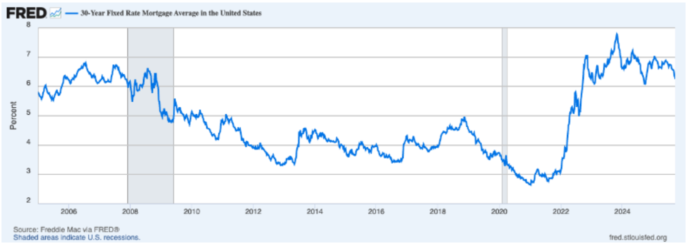
THE STEADY INVESTOR:
Key Weekly Events

- **Mortgage rates not Fed-driven**
- **401(k) catch-up rules shifting**
- **Global business activity still growing**

The Fed is Cutting Rates, But Does That Mean Mortgage Rates Will Fall Too?

With the Federal Reserve poised to continue cutting rates at future meetings, many assume mortgage rates will follow. But for would-be homebuyers (and sellers) anticipating a more affordable financing market, the connection isn't nearly as tight as headlines suggest. That's because the Fed controls overnight rates, which are very *short-term* borrowing costs. Mortgage rates are set by long-term interest rates, which tend to follow the 10-year U.S. Treasury bond yield. To understand what affects the 10-year, one must look at market forces, not central bank decisions. Why the 10-year and not the 30-year Treasury bond yield? Because most mortgages don't last 30 years in practice. Homeowners often move or refinance after about a decade, making the 10-year yield a more natural benchmark for pricing mortgage-backed securities. Inflation expectations, supply and demand for bonds, and global investor sentiment all play a role in moving 10-year yields. If investors worry that rate cuts today will reignite inflation tomorrow, they may demand higher long-term yields now. Case-in-point: just last year, the Fed cut rates by half a percentage point, and 10-year yields *rose* in the following weeks, pushing mortgage rates higher. To be sure, borrowing rates may drift lower from here as the Fed engages in further monetary easing. But if they do, it will likely be because inflation expectations fall and bond demand rises, not because of 25 basis point cuts.[1]

30-Year Fixed Mortgage Rates



Source: Federal Reserve Bank of St. Louis[2]

"Catch-Up" Contributions to 401(k)s are About to Change

For some time, working Americans over the age of 50 have been able to contribute extra dollars into retirement plans, known as "catch-up" contributions. The nature of these contributions is about to change for high income workers. Starting in 2026, some high-income workers will no longer be able to make *pretax* catch-up contributions to their 401(k) plans and will instead need to put those savings into Roth accounts, i.e., after-tax contributions that grow tax-free. The change comes from the IRS's finalized rules on a 2022 law and applies to workers who earned more than $145,000 in the previous year. While the basic contribution limit in 2025 will be $23,500, workers age 50 and older can put in an extra $7,500, and those aged 60 to 63 will qualify for an additional "super catch-up" of $11,250. But for high earners, all of that catch-up money must now go into a Roth.

In the worst-case scenario, if a high-income worker's 401(k) plan does not offer a Roth option, they won't be able to make catch-up contributions at all. While the new rule may sting for those accustomed to the pretax benefit, it could be a blessing in disguise for long-term planning. Many high earners are already top-heavy with pretax savings and may welcome the chance to build up more tax-free income in retirement. In fact, some advisors are encouraging clients to view this moment as a broader opportunity to consider making all their 401(k) contributions, regular and catch-up, in Roth format. In our view, with rules shifting and thresholds tightening, this is a smart time for retirement savers to re-evaluate how and where they're saving.[3]

U.S. and European Business Activity Continues Expanding

U.S. business activity expanded in September, though the pace of growth slowed slightly for a second straight month. That's the takeaway from S&P Global's flash purchasing managers' index (PMI), a widely watched measure of private-sector activity. The Composite PMI dipped to 53.6 from 54.6 in August, still well above the 50 mark that separates growth from contraction. The latest reading showed a modest cooling in both manufacturing and services. But critically, despite higher input costs, largely due to tariffs, businesses didn't pass those costs along to customers in the form of higher prices. The input price index ticked up to 62.6**,** while the output price index fell to 56.0, suggesting firms are absorbing more of their rising costs rather than risking customer pushback.

It's also true that most U.S. imports are *not* currently subject to sweeping tariffs, which likely helps explain why consumer inflation hasn't surged. Across the Atlantic, the eurozone's PMI edged slightly higher to 51.2 in September, marking its ninth straight month of growth. That modest uptick was driven largely by Germany, while France saw continued contraction, with a composite PMI of 48.4, its 13th consecutive month below 50. For investors, we think the big picture here is that global economic data continue to support a "muddle-through" environment, where moderate growth and above-average inflation coexist. For stocks, that can be a very workable mix, especially when expectations are low.[4]

[1] Wall Street Journal. September 18, 2025. https://www.wsj.com/economy/housing/what-decides-where-mortgage-rates-go-from-here-b5b09e35?mod=djemMoneyBeat_us

[2] Fred Economic Data. September 25, 2025. https://fred.stlouisfed.org/series/MORTGAGE30US#

[3] Wall Street Journal. September 24, 2025. https://www.wsj.com/personal-finance/retirement/high-earners-age-50-and-older-are-about-to-lose-a-major-401-k-tax-break-75572091?mod=djemMoneyBeat_us

[4] Reuters. September 23, 2025. https://www.reuters.com/world/us/us-business-activity-moderates-further-september-2025-09-23/

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