

Market Newsletter

Third Quarter 2025

EXECUTIVE SUMMARY

- The third quarter of 2025 saw strong gains across all major equity categories, fueled by resilient corporate earnings, optimism surrounding Artificial Intelligence, trade deals and a Federal Reserve interest rate cut.
- The Federal Reserve cut interest rates by a quarter of a percentage point saying the economy was slowing and that risks to employment were increasing.
- Despite persistent concerns over inflation and economic contraction, the U.S. economy has several points of resilience that offer a silver lining. Consumer spending is healthy, and trade negotiations are advancing.
- The top 10 companies in the S&P 500 account for over 40% of the index' market capitalization and a sizable portion of overall earnings and investments.
- The estimated earnings growth rate for the S&P 500 for the third quarter of 2025 is 8.0%. If expectations are met, it will be the ninth consecutive quarter of earnings growth for the index.
- The economic performance of non-U.S. countries has shown mixed results.
- Despite lower earnings growth and earnings quality, foreign stocks have had strong performance this year, helped by low relative valuation and a weakening US dollar.
- The key to navigating periods of potential turmoil lies in adopting a broad, long-term perspective. Maintain a sound financial plan tied to your specific goals and stick to it.

Table 1: Market indices

<i>(Returns include dividends reinvested)</i>	Quarter to date	Year to date	1 Year	3 Year Annualized	5 Year Annualized
S&P 500	8.12%	14.83%	17.60%	24.94%	16.47%
S&P Mid Cap 400	5.55%	5.76%	6.13%	15.84%	13.61%
S&P Small Cap 600	9.11%	4.24%	3.64%	12.82%	12.94%
MSCI Emerging Markets	10.95%	28.22%	18.17%	18.81%	7.51%
MSCI EAFE	4.83%	25.72%	15.58%	22.33%	11.71%
Vanguard Total Bond Market Index	1.91%	6.01%	2.75%	4.77%	-0.60%
Investment Grade Credit	2.76%	7.08%	4.04%	7.28%	0.57%
Non-Investment Grade Credit	2.41%	7.1%	7.23%	10.97%	5.54%
Bloomberg Commodity Index	3.65%	9.37%	8.89%	2.76%	11.53%
Dollar Index	0.92%	-9.27%	-2.98%	-4.46%	0.81%
10 Yr. Rate	4.15% 09/30/2025	4.57% 12/31/2024	3.80% 09/30/2024	3.80% 09/30/2022	0.68% 09/30/2020

Source: S&P Dow Jones, St Louis Fed, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

Table 2: Vanguard Life Strategy (Asset Allocation) Funds

	Quarter to date	Year to date	1 Year	3 Year Annualized	5 Year Annualized
Income (20% stocks)	2.84%	7.98%	5.78%	8.36%	2.39%
Conservative Growth (40% stocks)	4.87%	10.83%	8.77%	11.94%	5.19%
Moderate Growth (60% stocks)	5.29%	13.60%	11.62%	15.49%	7.94%
Growth (80% stocks)	6.55%	16.38%	14.56%	19.11%	10.73%

Source: Vanguard

Table 3: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)

As of 10/02/2025			
	Latest Release	Recent Trend	Notes
Non-Farm Employment	22,000	Negative	The jobs market has slowed down considerably in the last few months as per data released in September. Unemployment rate has inched up to a four-year high of 4.3%. There have also been significant downward revision of previously released data.
Weekly Claims for Unemployment Insurance	218,000	Positive	After perking up a bit earlier in the year, initial jobless claims for unemployment insurance remain low.
ISM Manufacturing Index (over 50 indicates growth)	49.1	Negative	The index ticked up a bit, but tariff uncertainty is still weighing on manufacturing activity. The index has remained below 50 since April.

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	Latest Release	Recent Trend	Notes
ISM Non Manufacturing Index (Over 50 indicates growth)	50	Negative	The services sector, as indicated by this index, has been growing at a slower pace since late 2024 and is currently barely expanding.
Consumer Prices (Month over month change)	0.4%	Negative	Prices of goods and services used by consumers inched up in September presumably because of Tariff strains. Year over year, inflation was 2.9%- well above the Federal Reserve's 2% target. Core CPI, excluding food and energy, increased 3.1%.
Producer Prices (Month over month change)	-0.1%	Positive	Prices received by producers dropped unexpectedly in August, primarily driven by a drop in services prices and energy costs. It seems falling demand is forcing producers to absorb higher Tariffs. Prices increased by 2.6% in the last year.
Retail Sales (Month over month change)	0.6%	Positive	Retail sales grew in August because of increasing prices as well as consumer resilience. It is possible that consumers are advancing purchases expecting further price increases.
Consumer Confidence (Conference Board)	94.2	Negative	Consumer confidence reached the lowest level since April 2025, hurt by inflation and a weakening job market. The expectations index remained below 80, a level often associated with a future recession.
Durable Goods Orders (Month over month change)	2.9%	Positive	Durable goods orders increased unexpectedly after two consecutive months of declines. The headline number was helped by a surge of transportation orders. Core capital goods orders increased by a healthy 0.6%.
Industrial Production (Month over month change)	0.1%	Positive	Industrial production unexpectedly rose in August, helped by manufacturing, especially, motor vehicle sales and mining.
Capacity Utilization	77.4%	Positive	Capacity utilization is below its long run average of 80 but above pre-pandemic level.
Housing Starts	1.307MM	Negative	Housing starts declined significantly, hurt by sustained pressure on builders from high borrowing costs, elevated construction expenses, and reduced housing affordability. The decline was equally split between single and multi family housing.
Home Prices (Case-Shiller Home Price Index- Year over Year)	1.80%	Negative	Home prices continued to rise but at a much slower pace than the recent past. Low home affordability is dampening demand for homes.
GDP (Real, Annualized)	3.8%	Positive	In the second quarter, the US economy grew at the fastest rate in nearly two years, helped by consumer spending and smaller imports.

Source: Bloomberg, www.federalreserve.gov, www.bls.gov, www.ismword.org, www.nahb.org

The third quarter of 2025 saw strong gains across all major equity categories, fueled by resilient corporate earnings, optimism surrounding Artificial Intelligence (AI), trade deals and a Federal Reserve (Fed) interest rate cut. Small US stocks were the outright leader, posting an impressive return for the quarter, reaching a new all-time high. Large US stocks also surged. Meanwhile, international stocks delivered solid gains helped by a resurgence of emerging market stocks. The broad participation in the rally signaled an expansion of market breadth. Lower interest rates helped bonds also deliver positive returns for the quarter.

The most notable development of the quarter came late in September, when the Federal Reserve cut interest rates by a quarter of a percentage point. This move lowered the federal funds target range to 4.00%–4.25%, the first adjustment since last Fall. The Fed’s decision reflected signs that the economy was slowing and that risks to employment were increasing. By acting cautiously, the central bank aims to support growth while continuing to watch progress on inflation.

For households and businesses, interest rates remain relatively high, even after the cut. Mortgage rates are elevated, limiting affordability in the housing market. (Fig 1 and 2) Auto loans and credit card borrowing costs also remain high. At the same time, savers continue to benefit from attractive yields on deposits and short-term investments.

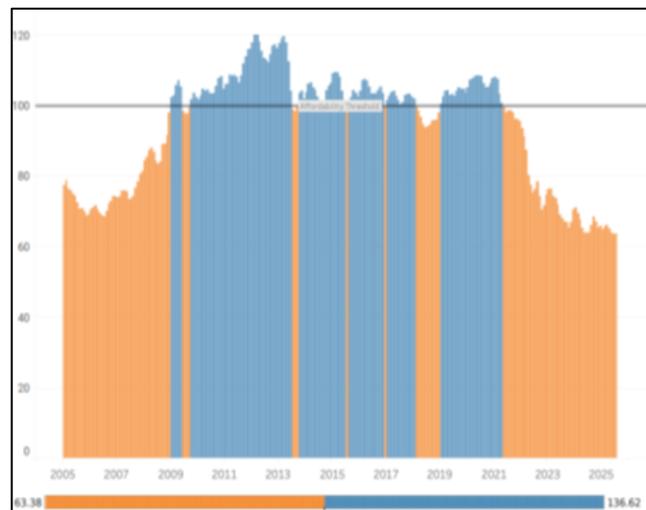
US manufacturing remained in contraction territory throughout Q3 though the rate of decline eased by September. The dominant Services sector, however, decelerated sharply, peaking in August before stalling in September. A key headwind across both sectors was the prevailing tariff situation. In Manufacturing, executives cited trade barriers as a major drag, causing higher input costs, supply chain uncertainty, and weaker export demand, raising fears of "stagflation." The Services sector was also impacted as companies noted that rising tariff-related costs on imported materials were being passed on, contributing to broader economic apprehension and delayed capital expenditures. (Fig 3)

Fig 1: Average 30- year fixed rate mortgage



Source: Federal Reserve of St Louis

Fig 2: Home affordability index (100+ means affordable)



Source: Federal Reserve of Atlanta

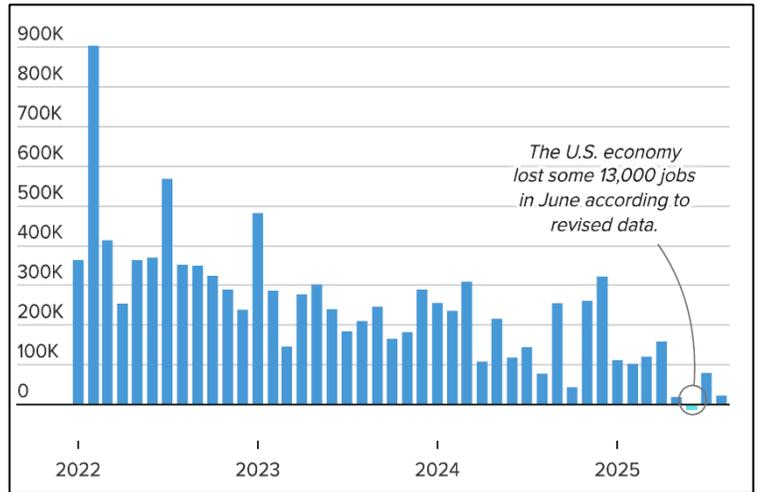
The US job market is showing clear signs of cooling over the last few months. (Fig 4). Job creation has slowed significantly, with one month even seeing a loss of jobs after downward revisions. The unemployment rate has ticked up, reaching its highest point in nearly four years. While the overall labor market is still relatively stable, the slower pace reflects growing employer caution amid economic uncertainty. Job gains have been concentrated in sectors like health care, but industries like manufacturing and wholesale trade have seen declines. Long-term unemployment is still a persistent challenge for job seekers.

Fig 3: Manufacturing and Services sectors have slowed



Source: Advisor Perspectives

Fig 4: Number of monthly jobs created have been falling



Source: CNBC.COM

Despite persistent concerns over inflation and economic contraction, the U.S. economy has several points of resilience that offer a silver lining. Consumer spending continues to show fundamental strength, contributing to overall economic expansion. Furthermore, the manufacturing sector, although facing challenges like tariffs, has shown crucial signs of stabilization, including improvements in new factory orders. This suggests that underlying domestic demand is proving durable against current external shocks. Lastly, easing pressures on prices paid for key inputs shows that the upward trajectory of inflation may moderate over time, potentially softening the risk of a severe downturn.

Trade negotiations between the United States and other countries advanced during the quarter, with the US reaching several trade deals, including with the European Union, the United Kingdom, and Japan. But it was unclear what levies may be imposed on goods from China, India, Mexico, and elsewhere. In the coming months, the US Supreme Court is also set to weigh in on a case to decide the validity of global tariffs that have been imposed by the current administration.

A significant hallmark of the current bull market is the outsized role played by the largest stocks in the stock market. The S&P 500 has a record high concentration in the top 10 companies, with the group accounting for over 40% of the index' market capitalization, which is a significant increase from historical averages and previous peaks. (Fig 5). This extreme concentration is largely driven by technology giants, particularly the "Magnificent Seven (Nvidia, Microsoft, Apple, Alphabet, Amazon, Meta and Tesla) which continue to grow on optimism about the benefit from AI. As seen in Fig 5, these companies account for a sizable portion of the S&P 500 earnings but are also investing large sums of money into AI hoping to stay competitive (Fig 6)

Corporate earnings continue to be robust, helped by increasing sales and improving margins. (Fig 7). According to FactSet, companies in the S&P 500 reported earnings growth (Year over year) of almost 12% in the second quarter, the third straight quarter of double-digit growth. Over 80% of the companies delivered earnings growth better than analysts expected. The growth was heavily concentrated and primarily driven by the Information Technology and Communication Services sectors, especially the Magnificent Seven. These companies continue to grow earnings at almost two times the pace of the rest of the US equity market, 22% vs 12%. (Fig 8).

The estimated earnings growth rate for the S&P 500 for the third quarter is 8.0%. If expectations are met, it will be the ninth consecutive quarter of earnings growth for the index. Sales are expected to improve by 6%. Analysts have been revising expectations upwards, which usually augurs well for actual reported earnings.

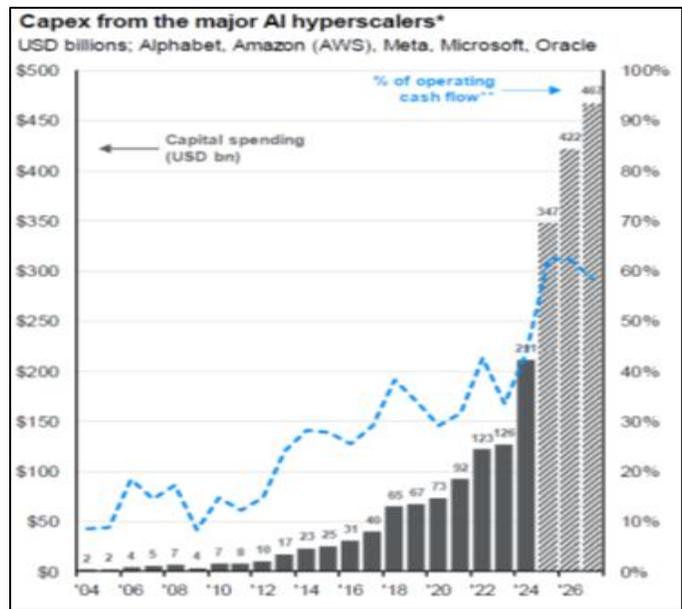
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Fig 5: Top 10 companies in the S&P 500



Source: JP Morgan

Fig 6: Significant investments in AI



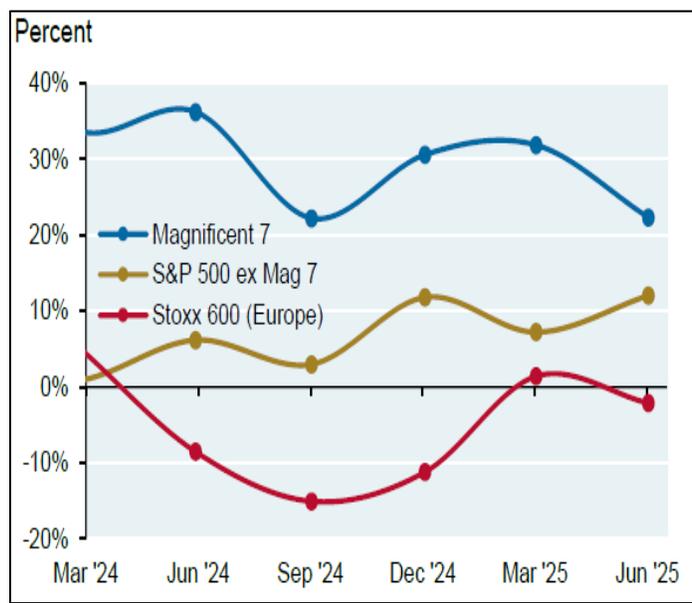
Source: JP Morgan

Fig 7: Corporate profit margins



Source: Ben Carlson

Fig 8: Year over year earnings growth.



Source: JP Morgan

The economic performance of non-U.S. countries has shown mixed results. Emerging markets like India and Indonesia continue to experience strong GDP growth driven by domestic consumption, infrastructure investment, and digital expansion. Meanwhile, China's economy faces headwinds from property sector woes and slowing exports, although government stimulus has provided some support. In Europe, growth remains subdued due to persistent inflation, tight monetary policy, and geopolitical tensions affecting trade although the large fiscal stimulus announced earlier in the year is expected to yield benefits in the near future.

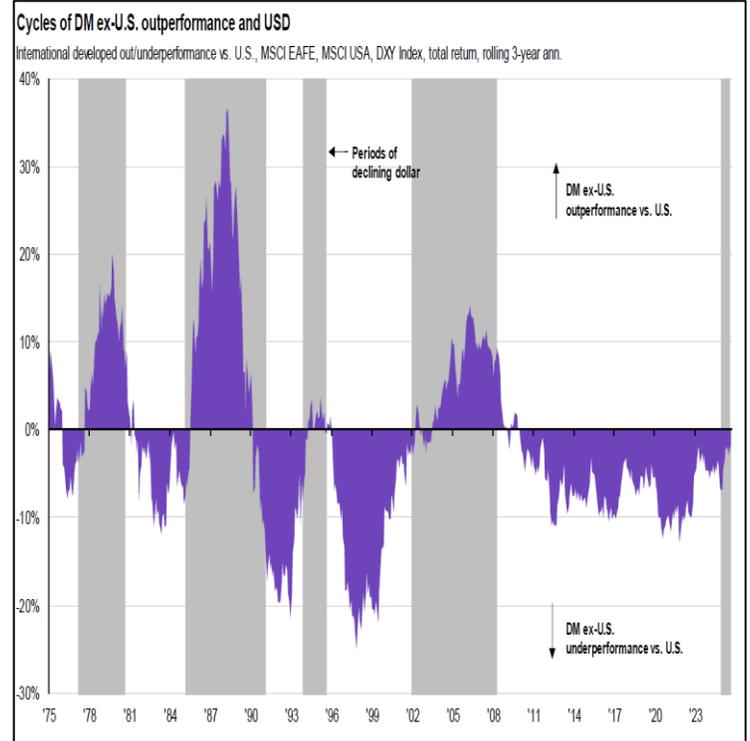
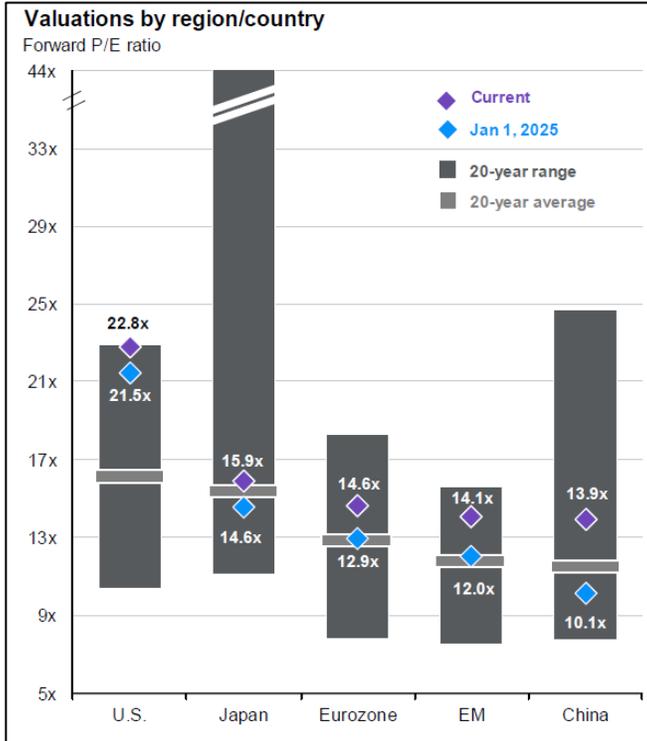
Corporate earnings outside the U.S. reflect these regional dynamics. European companies have posted modest earnings but were overall flat for the quarter (Fig 8). In Asia, tech companies in Taiwan and South Korea have seen a rebound due to global semiconductor demand, while Chinese firms struggle with weaker consumer sentiment. Overall, global corporate

earnings show resilience in select sectors, though uneven across regions. Currency fluctuations and geopolitical risks remain key factors influencing international corporate performance.

Despite lower earnings growth and poor earnings quality, foreign stocks have performed well this year, helped by low relative valuation (Fig 9) and a weakening US dollar. Historically, non-US stock performance has been strong in periods when the US dollar has weakened as seen in Fig 10.

Fig 9: Relative valuations of global equities

Fig 10: Foreign stocks do well when the US dollar weakens.



Source: JP Morgan

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As we enter the fourth quarter, it's understandable that geopolitical events and other global concerns are creating a sense of uncertainty for investors. You might be wondering what impact these issues could have on your portfolio.

However, a look back at market history provides a valuable perspective. Over the decades, investors have weathered an array of significant challenges—from periods of extreme inflation and profound financial crises to various global shocks. Through it all, markets have consistently proven their resilience, showing a remarkable ability to adjust to new information and, over time, reward a disciplined approach.

The key to navigating periods of potential turmoil lies in adopting a broad, long-term perspective. Temporary market disruptions are an expected part of the investing journey. History shows that the most reliable path to capturing the market's long-term growth potential involves three core components: having a resilient portfolio with broad diversification; maintaining a sound financial plan tied to your specific goals; and possessing the discipline to stick with that plan, even when short-term news might tempt you to act emotionally. Maintaining this disciplined approach has been successful in weathering difficult events and capturing the long-run returns the market offers.