

Market Update: Q3 2025

Equity markets pushed higher in the third quarter of 2025, showing broad strength and resilience across most sectors. The Dow, S&P 500, and Nasdaq all hit record highs, driven largely by Artificial Intelligence (AI) and technology stocks. In response to softening labor market data, the Federal Reserve initiated a much-anticipated 25-basis-point rate cut, despite inflation remaining above the Federal Reserve's 2% target. International equities and gold also delivered positive performance, supported by strong corporate earnings despite ongoing uncertainty surrounding U.S. tariff policies and their impact on global trade.

Strong Fundamentals

The primary drivers of U.S. stock performance in the third quarter were strong corporate fundamentals, continued momentum in technology and artificial intelligence (AI), and a shift toward easier monetary policy. While the market looked past the September rate cut announcement, as it usually does, the Fed's updated projections signal additional cuts ahead, offering near-term support for stock market valuations.

The 'Magnificent 7' technology companies continued to drive index performance, as shown in the chart at the top of Page 2. At the same time, corporate earnings in Q3 showed strong growth, exceeding analyst estimates. More than half of the S&P 500's 8.1% return was driven by profit growth, not just high-

Key Takeaways

- Tech and AI continue to fuel record-breaking index performance
- Strong corporate earnings - not just higher valuations - drove over half of the S&P 500's 8.1% return
- Shutdown fears didn't rattle the markets
- The Fed started a rate-cutting cycle in September

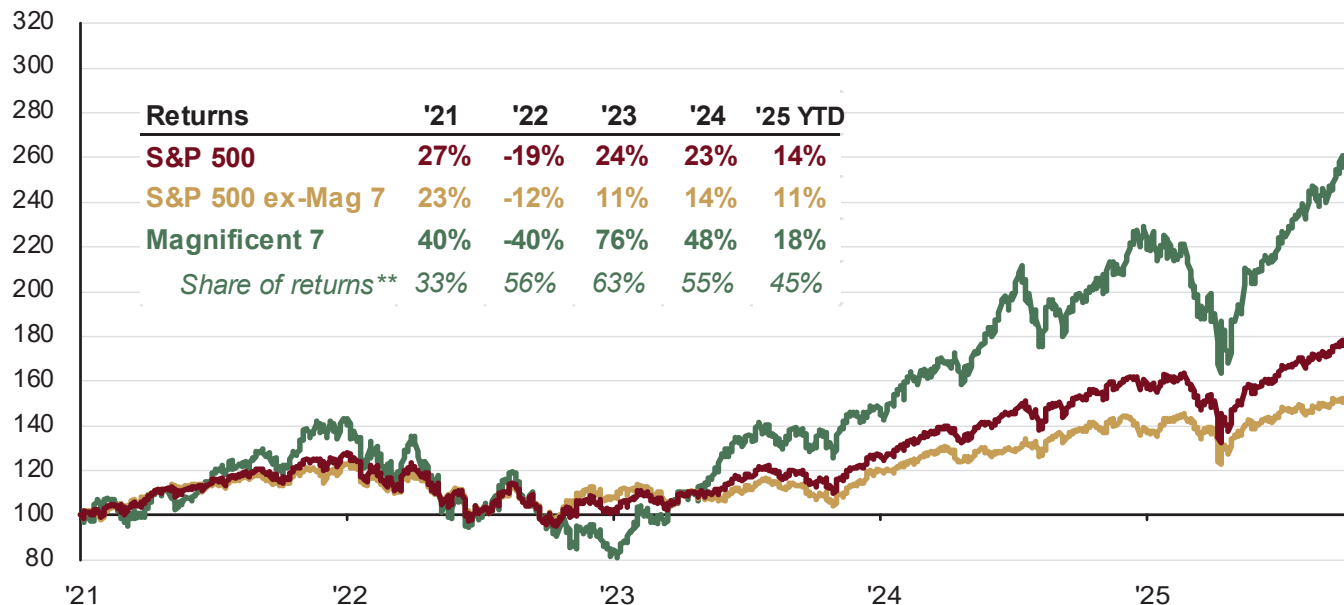
INDEX	Q3	YTD	1 YEAR	ANNUALIZED 3 YEAR
S&P 500	8.1%	14.8%	17.6%	24.9%
Russell 2000 Small Cap	12.4%	10.4%	10.8%	15.2%
MSCI EAFE - International	4.8%	25.7%	15.6%	22.3%
MSCI Emerging Markets	10.9%	28.2%	18.2%	18.8%
Bloomberg US Agg Bond	2.0%	6.1%	2.9%	4.9%

SOURCE: BLOOMBERG

er valuations, and reported earnings rose 11.7%, marking the third consecutive quarter of double-digit gains. So far, it's been difficult to discern whether changing tariff policies have directly affected corporate earnings.

PERFORMANCE OF “MAGNIFICENT 7” STOCKS IN S&P 500

INDEXED TO 100 ON 1/1/2021, PRICE RETURN



SOURCE: JP MORGAN

Is Artificial Intelligence a Genuine Concern?

We would be remiss not to address the popular notion that everything related to AI constitutes a massive market bubble, akin to the Internet mania of the late '90s. In our long experience, if the consensus believes we are in some form of a bubble, we surely are not.

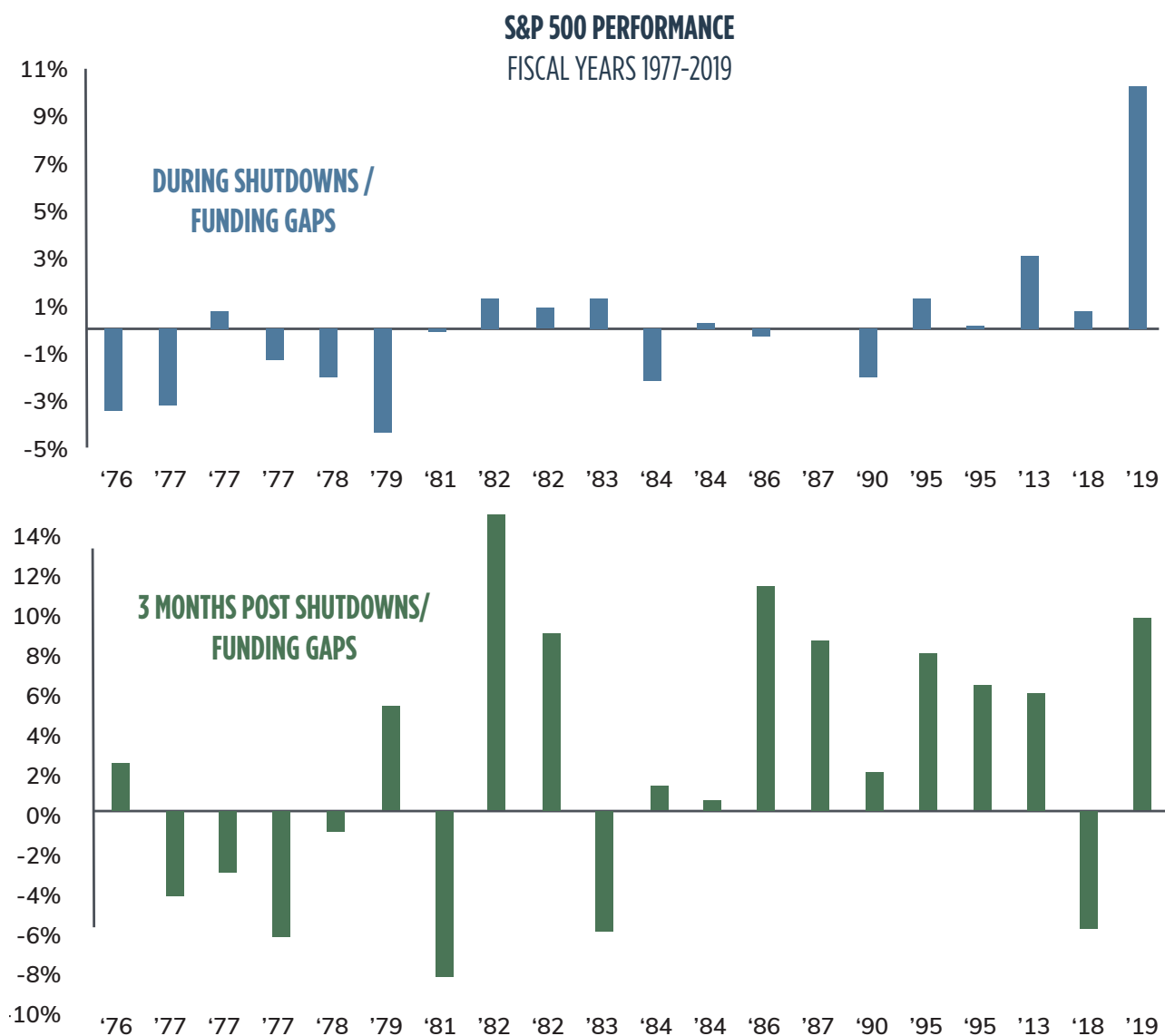
There is plenty of well-founded excitement—and ample misunderstanding—around the potential of these new technologies. Still, by most measures, investor sentiment remains far from the euphoric extremes we might expect to see in a real bubble. If anything, there remains considerable skepticism about the market rally itself and whether the extraordinary investments many tech companies are making in AI will pay off.

Our view is that AI is here now. Consumers and businesses are finding ways to be more

productive with these tools. While it can be difficult for investors and analysts to assess the true economics of the massive, headline-making investments announced almost weekly, most of the major companies in this space have long track records of exceptional and savvy capital deployment and maintain enormous and liquid balance sheets.

We certainly do not see signs of an AI bubble in these stocks. For example, NVIDIA is trading at a very reasonable 27 times next year's earnings—with revenues projected to grow more than 40% the next two years. And we find good value in the stock of venerable Microsoft, although it is growing at a slower rate. These are incredible franchises at the epicenter of the AI evolution, alongside a group of other companies with amazing fundamentals and reasonable valuations—such as Broadcom, Alphabet, and Apple, to name a few.

The press has recently raised concerns about



SOURCE: STRATEGAS

the symbiotic nature of several deals in which providers of AI infrastructure, such as NVIDIA and Broadcom, have given concessions to AI developers (Open AI, xAI, and others) to deploy their technology in the buildout of huge data centers. This has become known in the press as ‘circular financing.’ As a practical matter, most of these arrangements function as equity investments by vendors such as NVIDIA. We see no worrisome systemic risks in these alliances when we consider the vendors’ fortress-like balance sheets and

the growth potential within the AI universe of stakeholders.

Do Government Shutdowns Matter?

Not surprisingly, we have fielded lots of questions around government shutdowns. The data suggest that markets typically stagnate during shutdowns, but then move sharply higher in the following months (see charts above).

Outlook

By historical measures, the stock market is at the high end of its valuation range. But, as the old saying goes, “it’s not a stock market, it’s a market of stocks.” We are still able to build portfolios with superior fundamentals at reasonable valuations and we remain fully invested in equities, in line with each portfolio’s investment policy allocation.

We believe the strong earnings momentum this year can continue into Q4 – and the Fed finally started a rate cutting cycle in September. Softer jobs data, and most recently isolated credit concerns at several regional banks, should pave the way for further monetary easing which will help support elevated equity valuations and ease the cost of capital for smaller businesses.

Seemingly, this administration is keenly tuned into every tick of the Dow Jones, with any disruptive or confusing policy proclamation quickly followed up by market-reassuring rhetoric. Heading into the midterm elections, the administration is counting on the economy running strong.

For all of that, this market has some strong technical support, as shown in the data table to the right. In the six months following the April 8th market low, the S&P 500 gained more than 35%—the fourth-strongest market advance since 1950 after a correction of at least 15%. Such periods of strong performance after large drawdowns have typically been followed by additional gains over the next three to six months.

6 MONTHS SINCE THE APRIL 8TH LOW

S&P 500 PERFORMANCE OFF THE LOW FOLLOWING A -15% DRAWDOWN

High Date	Low Date	Draw-down	+125 Days Off Low	Next 65 Days	Next 125 Days
2/19/2020	3/23/2020	-34%	48%	11%	18%
10/9/2007	3/9/2009	-57%	48%	10%	14%
11/28/1980	8/12/1982	-27%	42%	13%	9%
2/19/2025	4/8/2025	-19%	35%	?	?
1/11/1973	10/3/1974	-48%	31%	15%	3%
2/21/2011	10/3/2011	-19%	29%	-4%	2%
7/17/1998	8/31/1998	-19%	28%	2%	8%
7/16/1990	10/11/1990	-20%	26%	3%	7%
12/20/2018	12/24/2018	-20%	23%	8%	13%
4/23/2010	7/2/2010	-16%	23%	6%	8%
10/9/2007	3/6/2009	-57%	48%	10%	14%
12/12/1961	6/26/1962	-28%	20%	7%	12%
2/9/1966	10/7/1966	-22%	20%	4%	10%
8/25/1987	12/4/1987	-34%	21%	8%	9%
3/24/2000	10/9/2002	-49%	22%	9%	8%
1/3/2022	10/12/2022	-25%	26%	7%	11%
8/2/1956	10/22/1957	-22%	22%	9%	10%
Average			26.6%	7.7%	10.2%
Median			24.1%	7.7%	9.8%

Oct. 7 was the 125th trading day since the 4/8 low, and the market was up 35%... the fourth-best recovery since 1950. In prior comps, rallies continued in the +3 and +6 months ahead.

SOURCE: STRATEGAS

Finally, there is a large supply of 'skeptical' cash still on the sidelines. If this market continues to grind higher, investors holding cash will certainly be looking for ways to get invested, which should support prices when the market dips.

More than anything, we are looking over the horizon. Yes, the near-term backdrop is con-

structive for both the economy and the stock market; but our mission is to compound our clients' capital over the long term by staying invested in companies that are successfully compounding their own.

This newsletter is intended for educational purposes only. For financial planning advice specific to your needs or for further information, please consult your portfolio manager.