October 2025

Quarterly Market Review

Third Quarter of 2025

Resilience Amidst Optimism

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The third quarter of 2025 reflected an encouraging mix of resilience and optimism. Despite lingering uncertainty surrounding tariffs, shifting global trade patterns, and the Federal Reserve's policy path, both economic and market performance remained robust. The S&P 500® Index advanced 8.1% for the quarter and is up 14.8% year-to-date, while the Bloomberg U.S. Aggregate Bond Index gained 2.0%, bringing its total return to 6.1%. Markets continue to climb a wall of worry - supported by strong fundamentals, yet increasingly priced for perfection.

Economic and Policy Backdrop

Economic momentum accelerated meaningfully this quarter. Q2 GDP growth was revised higher to 3.8%, underscoring broad-based strength in consumer spending, retail activity, and business investment. Importantly, fiscal incentives embedded in the "Big Beautiful Bill" - including immediate expensing of capital expenditures - have begun to spur corporate investment. Coupled with ongoing deregulation efforts, these measures form a durable foundation for growth extending into 2026. That said, signs of cooling in the labor market are emerging. Payroll growth has moderated in recent months, reflecting both a slowing pace of hiring and a sharp decline in immigration. With a smaller labor force, job creation needed to sustain low unemployment is less than in prior cycles but certainly bears watching.

We remain bullish on the economy, as policy tailwinds and rising productivity drive expansion. However, markets have largely internalized this optimism. Valuations in risk assets - including large-cap equities, high yield bonds, and corporate credit—reflect substantial good news. Any shortfall in policy execution or macro-outcomes will likely spark significant volatility.

Monetary policy remains a key uncertainty. The bond market continues to price aggressive rate cuts, with expectations of a 3% Fed Funds rate by late 2026. We view this as overly optimistic. Core CPI and core PCE have stalled near 3%, and structural shifts in global trade - reducing the disinflationary forces of the past 25 years - may keep inflation sticky. While productivity gains from AI and capital investment could eventually temper inflation, the Fed will need clear evidence of that trend before lowering rates materially. Our base case (absent a recession) anticipates a 3.5% terminal rate, reflecting a delicate balance between sustained growth and cautious monetary normalization.

Market Review

Equities:

Equity markets delivered another strong quarter, with gains broadly distributed but led by growth-oriented sectors. Information Technology (+13.2%) and Communication Services (+12.0%) were the clear standouts, powered by ongoing AI-related investment and digital infrastructure spending. Consumer Discretionary (+9.5%), Utilities

(+7.6%), and Industrials (+5.0%) also posted solid returns. In contrast, Consumer Staples (-2.4%) lagged meaningfully, reflecting defensive rotation outflows and margin compression.

Across market capitalizations, small-cap led the way, with the Russell 2000 advancing 12.4%, as optimism over potential Fed rate cuts reignited enthusiasm for rate-sensitive and cyclical equities. Midcaps were more restrained, with the S&P Midcap 400 gaining 5.5%, reflecting less sensitivity to the easing-rate narrative. Meanwhile the Bloomberg Magnificent 7 Index surged 17.6%, highlighting the continued concentration of market leadership. Factor performance showed Momentum (+11.1%) and Growth (+7.2%) strategies extending their dominance, while High Dividend Yield (+5.4%) and Minimum Volatility (+1.8%) lagged.

Fixed Income:
Bonds played a stabilizing but positive role. The Bloomberg U.S. Aggregate Bond Index gained 2.0%, while corporate credit outperformed Treasuries by a wide margin. Investment grade corporate excess returns (duration adjusted returns relative to U.S. Treasuries) were approximately +0.98%, and high yield corporates added +1.29% in excess returns, underscoring strong demand for spread product. Credit markets have largely shrugged off recession concerns, compressing spreads to near historical lows. While supportive for near-term returns, this compression leaves limited cushion should growth moderate or defaults tick higher.

Strategic Outlook

Our outlook remains constructive yet disciplined. We see durable economic expansion fueled by capital investment incentives, deregulation, and rising productivity. However, the combination of tight valuations and sticky inflation argues for tempered expectations across risk markets.

We maintain a cautiously optimistic stance - favoring high-quality growth exposures while staying selective in credit. Equity markets may continue to benefit from liquidity and earnings momentum, but stretched multiples and narrowing leadership highlight the importance of diversification. In fixed income, we prefer intermediate-duration corporates over long Treasuries, balancing yield opportunity with rate risk.

The Bottom Line

The third quarter reinforced the strength of the U.S. economy and the merits of disciplined portfolio construction. Our adaptive, long-term approach, anchored in diversification and valuation awareness has positioned clients to capture upside while managing risk prudently. As we enter the final quarter of 2025, optimism is warranted, but humility is essential. The economy's momentum is real, yet markets are priced for perfection. Our job is to stay ready for both.

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Disclosures

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Source: Index and sector performance Factset and Bloomberg