

Third Quarter Summary

Stocks climbed the proverbial wall of worry with most broad equity indexes ending the quarter at or near all-time highs. The S&P 500 increased 8.1% in Q3, buoyed by strong earnings, solid GDP growth, greater clarity on tariff policy, and the Federal Reserve's commencement of its interest rate cutting cycle. The artificial intelligence (AI) revolution continued to roll on, aided by NVIDIA reaching an all-time high with its market capitalization reaching an unprecedented \$4.5 trillion value. Unlike in past quarters, when the Magnificent 7 stocks far and away dominated, the gains were more uniform in Q3. The Russell 2000 of small capitalization stocks increased an impressive 12.4% over the quarter, followed by the Russell 1000 Growth (+10.4%) and Russell 1000 Value (+5.3%). Gold continued its torrid run, rising another 16.6% on increased geopolitical uncertainty, a weak U.S. Dollar, as well as the lowering of short-term interest rates, which make holding gold more attractive on a relative basis. The gilded metal has surged roughly 50% on a year-to-date basis. Bonds continued to act as ballast for diversified portfolios increasing at a slow but steady rate. The Bloomberg Barclays Aggregate Index increased 2.1% in Q3 and 6.2% on a year-to-date basis.

It may seem like déjà vu, but the federal government is in the midst of yet another shutdown. Government shutdowns, and their related cousin, the debt ceiling extension, have happened many times throughout history and have always been resolved. Although this time may be a bit different due to the Trump Administration's threat of significant government layoffs, we believe that this too will pass. Geopolitical risks continued to be a factor during Q3. The war between Israel and Hamas seems to be slowly coming to a resolution, including the possible release of the remaining Israeli hostages, but as the late baseball player and societal pundit, Yogi Berra, said, "It's ain't over till it's over." Perhaps more serious is the lack of progress for a resolution of the war between Russia and Ukraine. In fact, things have appeared to escalate with Russia testing the boundaries of the West with continued bombings of Ukraine and airspace incursions by Russian drones and planes into several NATO countries.

As noted above, the Federal Reserve cut interest rates for the first time in 2025. The Fed reduced short-term interest rates by 0.25% after its September meeting, although newly appointed governor, Stephen Miran, pushed for a larger cut of 0.50%. Further drama exists regarding the composition of the Federal Reserve. President Trump attempted to fire Fed governor, Lisa Cook, over allegations of mortgage fraud. However, the Supreme Court ruled that Ms. Cook may remain in her position, at least until further litigation is resolved. Furthermore, Treasury Secretary, Scott Bessent, is currently spearheading the interview process for the next chairperson of the Federal Reserve. Since current chair, Jay Powell, is slated to remain in his position until May of 2026, the prospect of appointing a new chair as soon as this fall increases uncertainty around central bank policy and independence.

Besides reducing short-term interest rates, the other noteworthy shift in monetary policy is the Fed's greater focus on the rise in the unemployment rate to 4.3% versus its other mandate, stable prices. Inflation, measured by both the Consumer Price Index (CPI) and Personal Consumption Expenditure Index (PCE), has continued to vacillate in the 2.5% to 3.0% range. One near-term casualty of the federal government shutdown is the absence of timely economic data, including the widely followed unemployment rate. Investors are not left completely in the dark since private firms typically issue their own reports, such as the Automatic Data Processing (ADP) National Employment Report.

As usual, earnings across the board came in better than expected, with more than 80% of S&P 500 companies exceeding expectations. Several companies cited improved clarity on tariff policy, although some uncertainties remain. One company merits special mention, Oracle Corporation. Until recently, Oracle was viewed as a somewhat stodgy database company. Yes, the bulk of its revenues are still derived from database related software and maintenance, but the firm is increasingly being viewed as an AI play. On September 10th, the company surged 36%, briefly making Oracle's founder, Larry Ellison, the wealthiest person in the world. Elon Musk has since regained this title. Oracle forecasted cloud revenue in excess of \$140 billion by 2030 largely due to its relationship with OpenAI,

creator of ChatGPT. If the OpenAI relationship wasn't enough to excite investors, Oracle is also rumored to be one of the acquirers of the American unit of TikTok.

Market Outlook

Investors remain enthusiastic about stocks, as evidenced by the markets reaching all-time highs. However, enthusiasm can sometimes turn into euphoria, with prices defying rational expectations. Although there appears to be some pockets of overvaluation, we remain modestly optimistic about equities over the next year due to attractive projected earnings growth, a decline in short-term interest rates, AI productivity improvements, and the positive impact on after-tax income of the One Big Beautiful Bill. Students of the stock market may recall the "irrational exuberance" comments in 1996 of former Fed Chair, Alan Greenspan. Jay Powell recently issued his own kinder, gentler, take on recent stock market prices. During a speech in late September, Powell characterized U.S. equities as "fairly highly valued." A brief selloff ensued, but investors quickly put those cautious remarks in the rearview mirror. Nevertheless, heightened stock market valuations and geopolitical risks temper our enthusiasm for equities, placing us more in the moderately bullish camp in contrast to the raging bulls that often appear in the financial media. We continue to believe in intelligent diversification as a fundamental principle in reducing portfolio risk and investor anxiety.

We expect the Fed to cut rates again after its October and December meetings. We expect further rate cuts to follow in 2026, especially once the new Fed Chair is installed. The Wall Street mantra "Don't fight the Fed" is one reason we do not wish to become too bearish, too quickly. We continue to believe bonds serve as ballast for diversified portfolios but realize that as short-term yields shrink due to Fed actions, other alternatives may help round out a carefully crafted diversified portfolio.

Political issues continue to impact the macroeconomic environment. As noted earlier, the war between Russia and Ukraine has the risk of spreading into a larger conflict, encompassing other NATO countries. Despite Q2 and Q3 GDP growth potentially exceeding 3%, we remain concerned about the long-term federal budget debt and deficits. Long-term interest rates are unlikely to fall as much as short-term rates, resulting in substantial interest payments accounting for an uncomfortably large portion of the federal budget. However, we wish to end on a positive note. We are enthusiastic about the deficit reduction possibilities of the new U.S. Sovereign Wealth Fund. The federal government has taken equity stakes in a number of companies, including Intel. Of course, past stock market performance may not be indicative of future returns, but it would be heartening to see a "win-win" scenario unfold, with rising stock prices accompanied by a shrinking federal deficit and debt.

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