

Steady Gains Amid Easing Policy

The third quarter of 2025 saw positive market performance amid the Federal Reserve's first rate cut of the year, reflecting easing policy and resilient earnings despite slower labor market growth.



MARKET REVIEW
SEPTEMBER 2025

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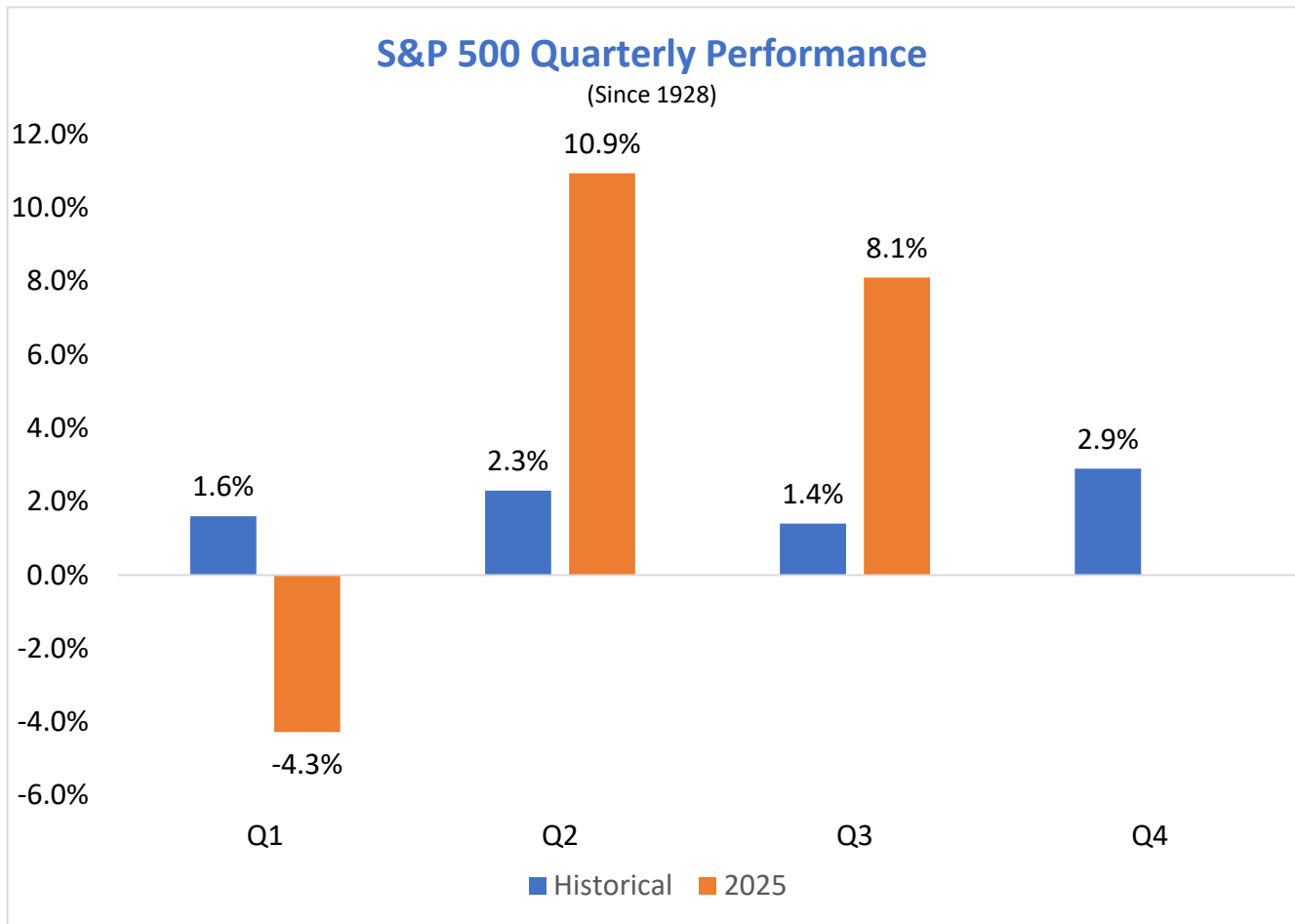
The third quarter of 2025 reflected a broadly positive market environment as the Federal Reserve initiated its first rate cut of the year, lowering the policy rate by 25 basis points to 4.0–4.25% amid signs of softer labor conditions and slower private-sector growth. Global equities advanced, led by Asia’s technology-driven gains, Japan’s trade tailwinds, and solid U.S. earnings. The S&P 500 rose 8.1%, while European and UK markets delivered more modest returns. Valuations returned to elevated levels, reflecting strong sentiment but suggesting limited forward return potential. Fixed income benefited from lower Treasury yields and tightening spreads, with investment-grade corporates maintaining a favorable carry profile even near historical spread lows. While inflation risks and policy uncertainty remain, lower rates and resilient earnings provided a supportive backdrop for risk assets through year-end.

Monetary Policy: The Fed lowered its policy rate by 25 basis points to a 4.0–4.25% range, in line with expectations. The updated dot plot suggests two more cuts are possible before year-end, with October and December meetings in focus, though Chair Powell emphasized that future moves are not guaranteed and described today’s step as a “risk management cut.” Concerns about employment weighed heavily on the decision, with the statement highlighting slowing job gains, a modest rise in unemployment, and increased downside risks to labor markets. Powell acknowledged the unusual dynamic of both labor supply and demand slowing, leading to a softer but not collapsing job market.

Growth in the U.S. private sector has slowed meaningfully in 2025, driven partly by structural labor shortages but also by cyclical shocks earlier in the year that reduced payroll gains. Hiring has softened, with job seekers finding fewer opportunities as openings trend lower, though widespread layoffs remain limited. Political uncertainty, tariffs toggling on and off, questions around Fed leadership, has added to the drag. Looking into 2026, conditions should improve as the new tax bill bolsters corporate capex, deregulation supports business activity, and benign credit conditions allow momentum to build. The Fed’s move toward neutral policy is a critical part of this adjustment, with debate centering on how low rates will ultimately go. A real Fed funds rate of about 1% appears a reasonable long-term anchor and recent upticks in mortgage refinancing underscore the sensitivity of growth to lower rates.

Equities: Asian equities led global markets in the third quarter of 2025, buoyed by renewed optimism around technology and easing trade tensions. The MSCI Asia ex-Japan Index rose 11.1%, with Chinese tech stocks surging, driven by policy support for domestic chipmakers, increased AI investment, and improving U.S./China relations. Taiwan’s tech-heavy market also advanced. Japan’s TOPIX Index climbed 11.0%, supported by a weaker yen, a new U.S./Japan trade deal reducing tariffs, and continued corporate governance reforms. In the U.S., the S&P 500 rose 8.1% despite mid-quarter volatility tied to payroll data and Treasury sell-offs. Strong earnings, steady growth, and a 25 basis-point Fed rate cut in September underpinned gains. UK equities gained 6.9% as global exposure, and a weaker sterling offset domestic economic headwinds.

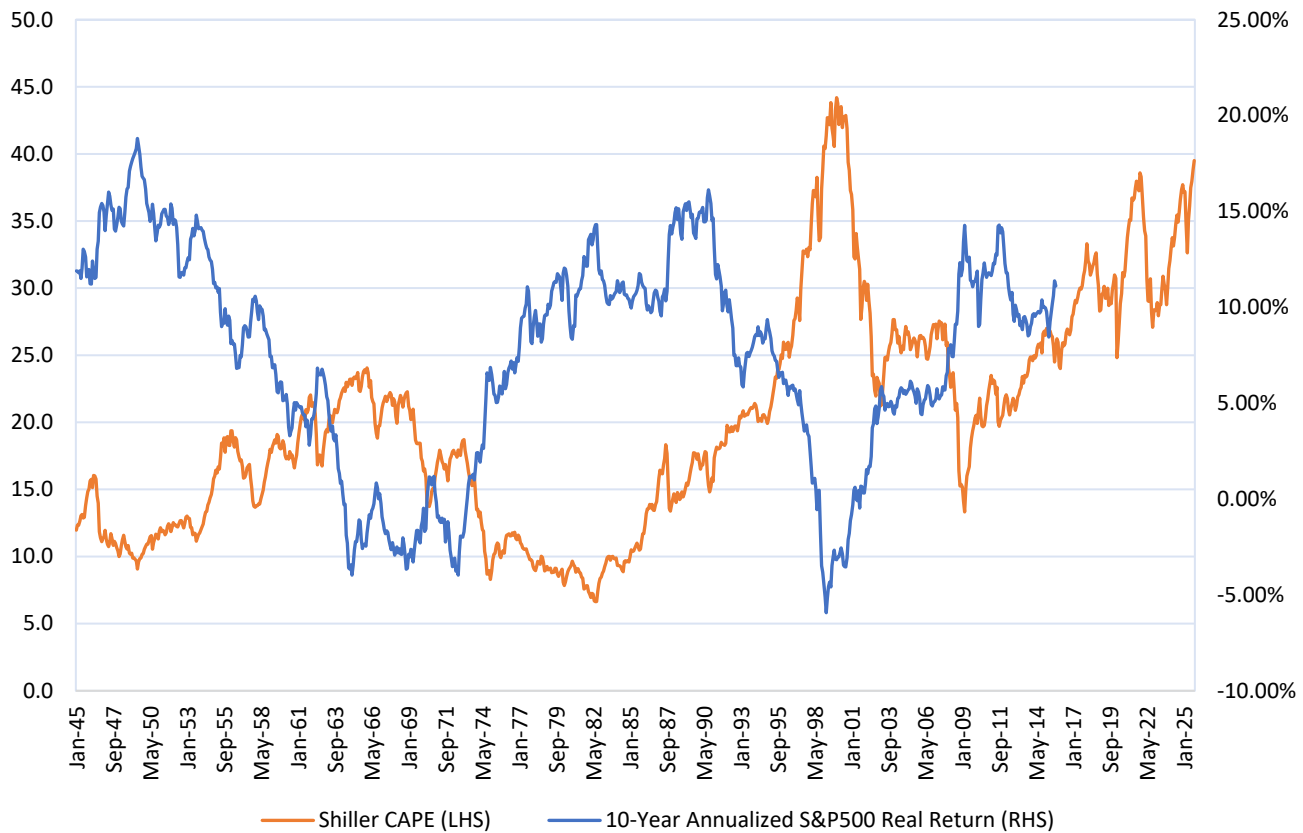
Continental Europe lagged, with the MSCI Europe ex-UK Index up just 2.8%, dragged down by Germany's 1.2% decline.



Sources: Strategas, eVestment

Equity valuations have surged back to peak levels, with the market trading far above the long-term averages. This indicates strong investor sentiment, but also suggests the market is far from cheap and that prospects for future outcomes should be modest. At the same time, history shows valuations have limited usefulness as short-term timing tools. Since 1950, the CAPE ratio has had almost no correlation with one-year forward returns, though its link with 10-year returns has been much stronger. This long-term relationship has weakened in recent years, pointing to other forces at work, most notably shifts in sector composition. Technology's weight in the index has grown from 10% in the 1970s to more than 25% today, while Staples and Energy have declined sharply. That tilt toward higher-multiple businesses helps explain why valuations appear structurally elevated compared to past cycles. Historically, technology averaged about 17% of the index in the 1990s, suggesting today's floor and ceiling for multiples could be higher. At the same time, defensive sectors are underrepresented relative to their earnings contribution, diverging from past patterns when they tended to gain share in downturns.

Shiller CAPE vs Subsequent 10-Year Stock Returns



Sources: shillerdata.com

Fixed Income: Overall, spread tightening and solid demand across sectors drove credit's continued outperformance. UST yields declined, especially at the long end. Corporates outperformed Treasuries despite heavy supply, led by utilities, with spreads tightening across sectors. Financials benefited from the risk-on tone ahead of 3Q earnings. Securitized credit was also broadly positive. Agency RMBS outperformed on dovish Fed signals and lower yields, CMBS outperformed modestly despite supply growth and soft labor data, and ABS outperformed with strong issuance and robust investor demand even after stress at a subprime auto lender.

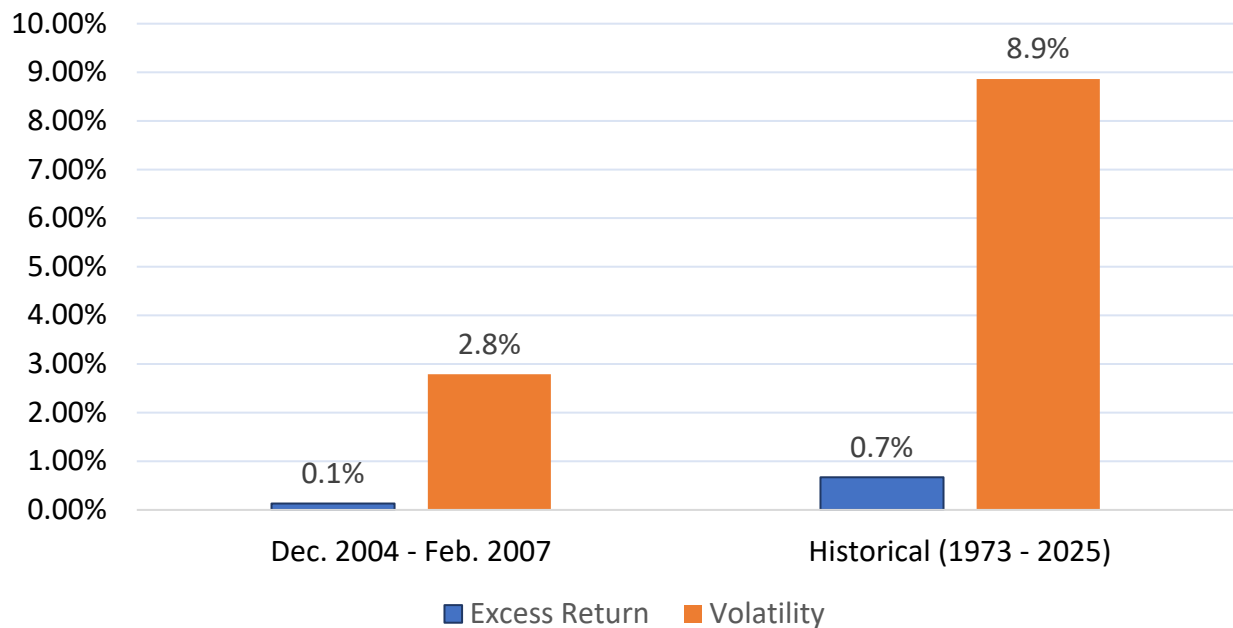
U.S. Treasury Yields

	YTM	Q/Q Change	Y/Y Change
3-Month T-Bill	3.93%	-0.52%	-0.84%
2-Year Note	3.61%	-0.11%	-0.03%
5-Year Note	3.74%	-0.05%	+0.17%
10-Year Bond	4.15%	-0.08%	+0.36%
30-Year Bond	4.73%	-0.06%	+0.60%

Source: Strategas

Even with investment-grade corporate spreads sitting near historical lows, history suggests investors should be cautious about underweighting the asset class. Over the long run, IG corporates have delivered stronger returns than the Aggregate index, though with higher volatility. However, in past cycles when spreads were this tight — such as Dec 2004 to Feb 2007 — they stayed compressed for two to three years, with only modest reversals. During these periods excess return potential diminished but so did volatility, leaving the risk/reward profile still compelling relative to Treasuries. If spreads remain range-bound, as they have in prior episodes, corporates could continue to outperform by clipping coupons with less volatility contribution.

Bloomberg IG vs Bloomberg Aggregate



Source: eVestment. Excess Return = Bloomberg Investment Grade Credit minus Bloomberg US Aggregate.

Real Assets: Commodities advanced 3.7% in the third quarter, supported by a rally in gold that offset a 0.8% decline in oil prices driven by supply expectations and lingering geopolitical uncertainty. Real estate performance was more muted than overall equity markets, with the FTSE EPRA/NAREIT Developed Index rising 4.3% in Q3 and 11.3% year-to-date. Within the REIT universe, health care remains the top-performing sector, followed by diversified and gaming. Within private real estate, transaction volumes have recovered, and pricing has remained stable without significant pressure in either direction. Prices are more likely to drift higher than lower, but any movements should be modest.

History shows that once inflation takes hold, a second wave often follows. However, it can take several years to fully unfold. Tariffs could accelerate a near-term shift in overall price levels, and the trajectory of rent inflation will likely play a critical role in determining how this trend develops.

Diversifying Strategies: Hedge fund performance rose for the fifth straight month in September, led by Macro and quantitative CTA strategies as the Federal Reserve's rate cut and rising M&A activity

helped returns. The HFRI Macro (Total) Index topped strategy performance, supported by falling interest rates and commodity gains. Equity Hedge funds advanced in September, with Healthcare, Energy, and Multi-Strategy managers driving results, bringing the HFRI EH (Total) Index to a leading +13.6% year-to-date. Fixed income-oriented Relative Value strategies also gained for the month as yields declined, and investors priced in further rate cuts. Event-Driven funds rose, buoyed by renewed M&A momentum and robust AI-related corporate investments.

Investors have long understood that purchase prices shape eventual returns. In today's private equity market, it has also become a reliable indicator of exit timing. Analysis from Pitchbook shows that buyout deals struck at the richest entry multiples are taking much longer to exit than those acquired at more modest valuations. For example, among transactions from 2020 to 2022 — when valuations peaked — only 12% of companies bought in the top quartile of entry multiples have exited, compared with more than 30% of those in the lowest quartile. Looking further back at the 2017 to 2019 cohort of platform investments, just over half of the priciest deals have exited, versus more than two-thirds of the least expensive. These patterns highlight that higher-priced companies require more time to grow into their valuations, often needing stronger revenue growth, operational gains, or multiple expansion. Meanwhile, portfolio aging is accelerating: the median age of active buyout-backed companies has risen to 3.8 years, up from less than three years in 2021. Longer holding periods are extending fund lives, slowing investor commitment pacing, and weighing on new fundraising. In today's environment, where capital formation increasingly depends on realizations, valuation discipline is vital not only for protecting returns but also for preserving liquidity and keeping the capital recycling engine turning. Overpaying doesn't just hurt performance, it costs time.

Exhibit 1: Asset Class Returns (2016 – YTD 2025)

2016	2017	2018	2019	2020	2021	2022	2023	2024	YTD
High Yield 17.1%	Intl Equity 27.2%	IG Bonds 0.0%	US Equity 31.5%	US Equity 18.4%	US Equity 28.7%	Cmdty 16.1%	US Equity 26.3%	US Equity 25.0%	Intl Equity 26.0%
US Equity 12.0%	US Equity 21.8%	High Yield -2.1%	REITs 23.1%	60/40 14.0%	REITs 27.2%	Diversifying -1.7%	60/40 18.0%	60/40 15.5%	US Equity 14.8%
Cmdty 11.8%	60/40 14.5%	60/40 -2.6%	60/40 22.4%	Intl Equity 10.7%	Cmdty 27.1%	High Yield -11.2%	Intl Equity 15.6%	Diversifying 9.8%	60/40 11.4%
60/40 8.3%	REITs 11.4%	US Equity -4.4%	Intl Equity 21.5%	Diversifying 8.4%	60/40 16.6%	IG Bonds -13.0%	High Yield 13.5%	High Yield 8.2%	REITs 11.3%
REITs 5.0%	Diversifying 7.5%	Diversifying -4.7%	High Yield 14.3%	IG Bonds 7.5%	Diversifying 9.8%	Intl Equity -16.0%	REITs 10.9%	Intl Equity 5.5%	Cmdty 9.4%
Diversifying 4.8%	High Yield 7.5%	REITs -4.7%	Diversifying 8.9%	High Yield 7.1%	Intl Equity 7.8%	60/40 -16.1%	Diversifying 7.4%	Cmdty 5.4%	Diversifying 8.5%
Intl Equity 4.5%	IG Bonds 3.5%	Cmdty -11.3%	IG Bonds 8.7%	Cmdty -3.1%	High Yield 5.3%	US Equity -18.1%	IG Bonds 5.5%	REITs 2.0%	High Yield 7.2%
IG Bonds 2.7%	Cmdty 1.7%	Intl Equity -14.2%	Cmdty 7.7%	REITs -8.2%	IG Bonds -1.5%	REITs -24.4%	Cmdty -7.9%	IG Bonds 1.3%	IG Bonds 6.1%

Source: IG Bonds = Bloomberg US Aggregate; US Equity = S&P500; Intl Equity = MSCI ACWI xUS; High Yield = Bloomberg US Corporate High Yield; REITs = FTSE EPRA/NAREIT Developed; Cmdty = Bloomberg Commodity; Diversifying = HFN Hedge Fund Aggregate; 60/40 = 60%S&P500/40%Bloomberg US Aggregate

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