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Investment Review & Outlook
2025 Third Quarter Investment Report

Whew! The U.S. equity markets kept testing new highs through the month of September – the month which has seen some of the biggest market downturns in our economic history. The price/earnings ratio (currently above 27) for the S&P 500 is actually higher than it was right before the 1987 and 2000 stock market crashes. Reaching these highs in the tricky month of September might have been a recipe for a significant market event – which can generate panic selling at the bottom and the regretful sabotage of sound retirement portfolios.

A breakdown shows that just about every U.S. investment category experienced moderate to robust quarterly gains. Looking at large cap stocks, the widely-quoted S&P 500 Index of large company stocks gained 7.79% in the third quarter, to bring investors a 13.72% gain for the year so far.

As measured by the Russell 2000 Small-Cap Index, investors in smaller companies are sitting on a 10.39% gain for the year after a big third quarter rally. The technology-heavy Nasdaq Composite Index gained 11.24% in the third quarter and is now up 17.46% for the first three quarters of 2025.

Foreign markets are still outpacing the U.S. equity scene. The broad-based EAFE Index of companies in developed foreign economies gained 4.80%, in dollar terms, in the third quarter of 2025, now delivering a robust 25.70% return for the first half of the year. Emerging market stocks of less developed countries, as represented by the EAFE EM Index, gained 10.90% in dollar terms in the recent quarter, posting a 26.60% gain for the first three quarters of 2025.

In the bond markets, the yield inversion continues. Treasuries of 3-month (3.92%) and 6-month (3.82%) duration are yielding more than government securities with 1-year (3.57%) and 5-year (3.74%) durations. 30-year government bonds are holding steady at 4.75%; 10-year maturities are yielding 4.25%. Five-year municipal bonds are yielding 2.31% in aggregate, while 30-year munis are yielding 4.30%.

The economic and corporate news continues to be positive heading into the final three months of the year. Both the Nasdaq and the S&P 500 indices posted their best September returns in 15 years, gaining 5.6% and 3.5% respectively. The large cap companies that make up the S&P 500 are projected to see 7.9% year-over-year earnings growth in the third quarter, which, if it holds up, would mark the ninth consecutive quarter of growth.

Economists, who seem to be paid to worry and raise alarm bells, have noted that the inflation rate has been stubbornly above the Federal Reserve's 2% target (currently 2.92%, up from 2.7%), and nearly a million fewer jobs were created in the U.S. in the most recent 12 months than in the prior time period – a sign that the unemployment rate could be ticking up with the next report. The on-again, off-again tariffs create additional uncertainty, although most economists now seem to think they will generate only a temporary rise in consumer prices.

Meanwhile, the recent 0.25% rate cut by the Fed was designed to give the economy a mild boost, and many economists are expecting a second cut between now and the end of the year. We won't get the next quarterly GDP report until October 30, covering the third quarter, but the 3.8% GDP increase in the second quarter is encouraging.

By far the biggest unknown is when Congress will end its stalemate and the government will be back in business from the current shutdown. A prolonged shutdown would allow the President to fire tens of thousands of government workers – something the Democratic representatives are unlikely to favor.

Even so, a brief shutdown might not be tremendously damaging to the American economy. Air traffic controllers and Transportation Security Administration employees are considered essential workers and would keep the airports running. The postal service wouldn't shut down. There would be delays in Social Security and VA services, but otherwise the biggest impact would be felt by federal workers and active-duty military service members who would not receive a paycheck during a government shutdown – and then have their lost wages made up when the stalemate ends. The longest-lasting shutdown, from late 2018 into the following January, lasted just 35 days, and by all accounts had minimal lasting economic impact.

In other words, the data is a confusing jumble of signals that tell us very little about the future, and particularly the future of the investment markets. We know that a downturn is somewhere in our future, and that someday the economy will experience another recession.

And we also know that, based on the historic growth of the economy and the companies that make it up, these things don't really matter much in the long term.

As always, please reach out with any questions. If your circumstances have changed, please let us know and we can schedule a meeting to discuss.

The FAM Team