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PRIVATE WEALTH

Q4 2025 Market Outlook

Ascending A Wall of Worry

"The voyage of the best ship is a zigzag line of a hundred tacks. See the line from a sufficient distance, and it straightens itself to the average tendency."
– Ralph Waldo Emerson, Self Reliance and Other Essays

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Any rational human may look at the state of the economy along with the multitude of simmering geopolitical events and assume this means it's time to bunker in and prepare for a recession, or worse. The world feels on the brink of falling apart at the seams- either another Middle Eastern crisis, or Russia going after NATO, or the USA ripping itself apart as rhetoric continues to enflame differences and makes coming together harder. While we are not minimizing multiple tragic and difficult circumstances both at home and abroad, the market does not care. The stock market is cold and calculating, unencumbered by fear and doubt, powered ever higher by data, earnings growth, capex, new technologies and expanding profit margins. The litany of what-ifs and all that can go wrong is a long list, and there is always a reason to doubt the markets, just make sure you check your emotions and base your decisions on facts and not fear of what could happen. Our emotions are often the largest blockade to a successful investment strategy, and it is hard to stay the course when bombarded by bad news. However, we feel if you peel back the talking points and take a look at the data and drivers of this bull market- there is a lot to like.

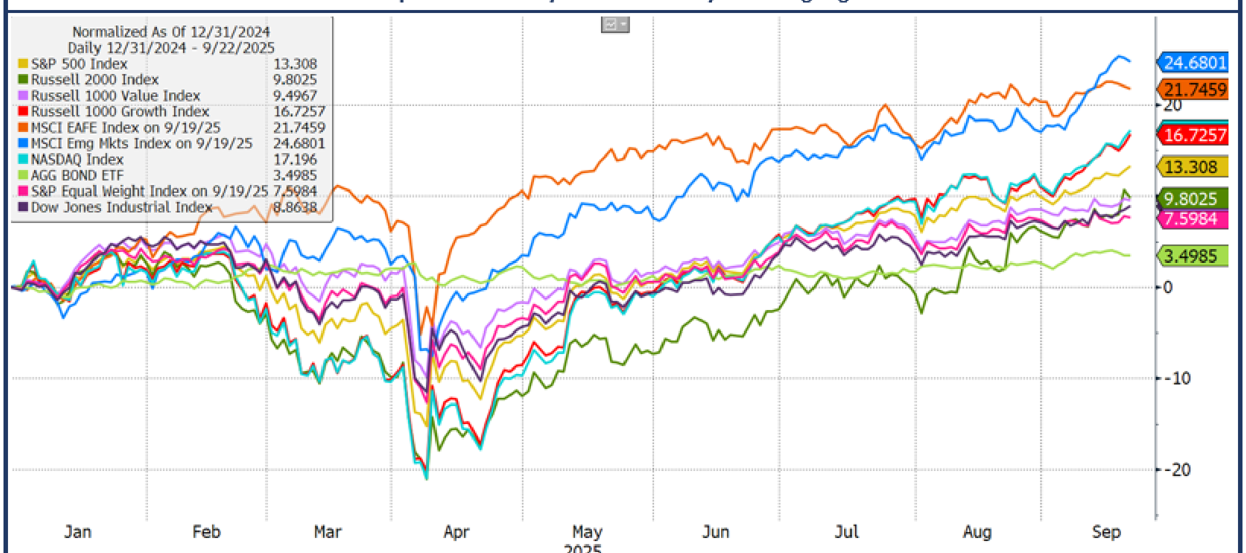
We are not permabulls; we are not hiding our head in the sand ignoring some of the bad data points that exist. We just don't think it matters yet. The stock market is not the economy. Yes, there are cracks forming, yes valuations are high, and yes if you want to find a reason why it may fail you can certainly find the data to validate it. Inflation is sticky and the potential of stagflation lurks, the labor market seems stuck in neutral at best, and the ever-changing tariff and immigration landscape makes it challenging for businesses to plan efficiently. Still, there are multiple catalysts coming in the next 12 months that can push the markets up further. Yes, eventually this will come falling back to earth- nothing escapes the gravitational pull of an eventual bear market. But that may be a way off still. Our tentpoles supporting our bullish thesis are split into 4 main groups: AI is still in early innings and capex spending is massively expansionary, rate cuts are coming to stimulate the economy, earnings growth + margin expansion = bull markets, and history is on the side of the bulls.

As we close out Q3, it may be hard to remember all that has happened over the last 9-months as it feels like we have lived through multiple economic cycles, crises, disasters and recoveries all packed into ¾ of a year. Remember Liberation Day? Yeah, that was only 6 months ago.

- The S&P 500 entered 2025 trading at 5,881.63 and promptly fell -4.59% in Q1.
- Then came Liberation Day 4/2, sending markets down -12% in 3 trading days before a policy pause.
- Post-Liberation Day markets rallied off the lows of 4,835.04 have now reached +33.75% (AS OF 9/19), a monstrous, rapid recovery, with the S&P 500 now up 14.37% YTD (including dividends) through 9/19.
- International markets are performing stronger than US markets YTD.
- On average, over the last 5 years, the S&P 500 has returned 8.54% in Q4.

After the seismic events of Liberation Day, the markets have been remarkably resilient. Logging NO down days greater than -2% since mid-April, with the largest daily drawdown at -1.61% on 5/21/25 and on only 3 trading days have the markets dropped more than -1%. A remarkably smooth and untroubled rally, notching multiple new record highs. You may be perturbed by what is happening geopolitically, but the bull market certainly is not.

Keep Calm and Rally On. Relentlessly Marching Higher



Source: Bloomberg LP. Chart made by V. Greene. Data as of close Friday 9/19/25

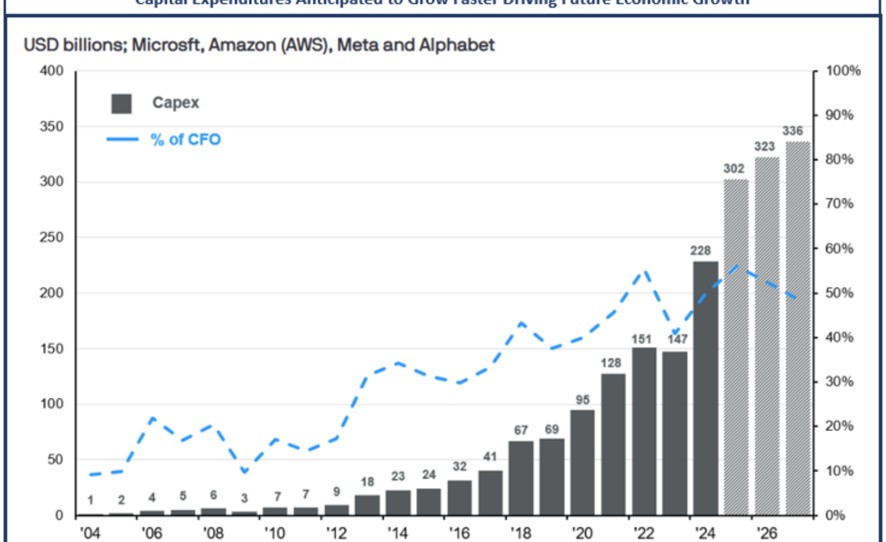
And it's not just technology driving the markets higher- the rally extends far beyond the Magnificent 7 stocks (AAPL, AMZN, GOOGL, META, MSFT, NVDA, TSLA). Only 4 of the 7 stocks are outperforming the S&P 500 this year with TSLA, AAPL, AMZN all lagging the S&P 500 as of close 9/19. If you look on a sector basis, 10 of 11 sectors are positive this year with only the much-maligned health sector lagging due to multiple headwinds such as the MAHA movement as well as potential seismic shifts in Medicare/Medicaid and UNH absolutely imploding on itself. Leading sectors include Communications (GOOGL, NFLX), as well as Infotech (AI driven), but also include Industrials and Financials. This is still a growth and technology driven market but it's not the ***only*** part of the market working anymore. Breadth has improved dramatically with 63% of the S&P 500 trading above their 200-day moving averages and 56% above their 50-day. Small caps finally rallied to new all-time highs, finally catching up with their large cap peers. Large and small, US and international, growth and value are all participating in the rally party.

As we turn the page to the 4th Quarter, we remain bullish due to 4 main catalysts: AI & capex, Fed rate cuts, profit growth & margin expansion, and historic bull market patterns.

<u>AI is Just Getting Started</u>

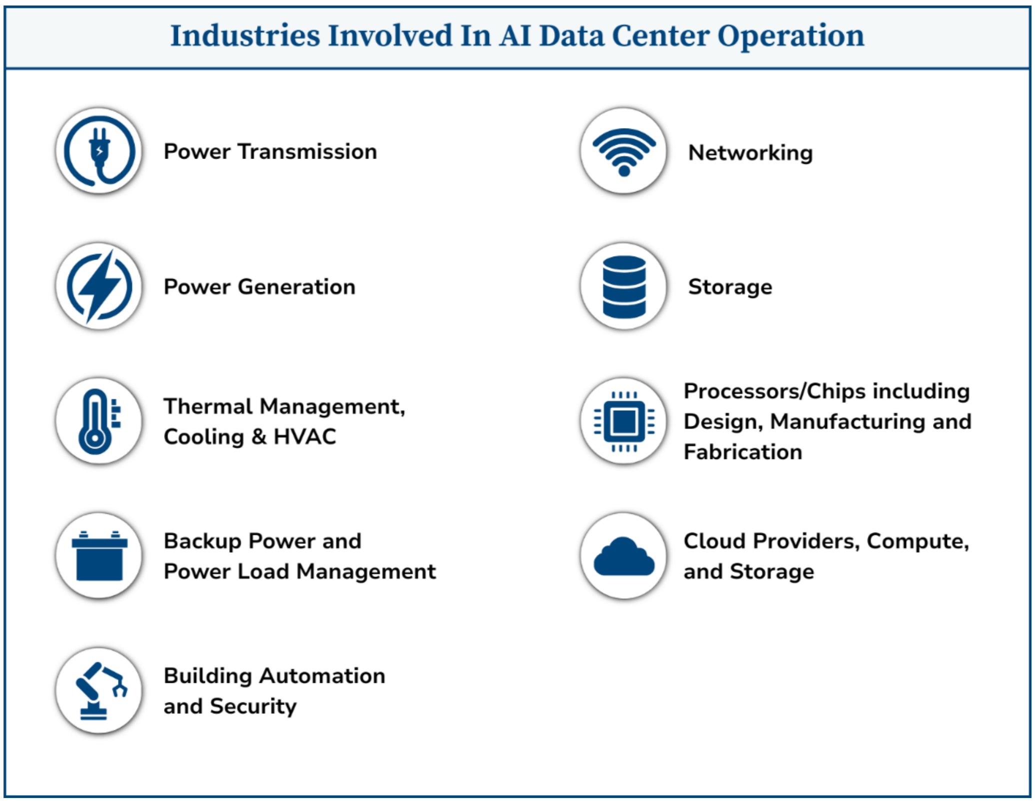
Attend any conference or webinar and you are inundated with new AI rollouts. We argue actual implementation of AI is just getting started. Yes, of course, you can add a nice chat bot pretty easily, or a notetaker to make life easier. But truly implementing AI across a global enterprise, that takes significant review and coordination. Do you buy modules owned by 3rd parties, or do you work to build your own systems from scratch? How do you ensure you stay modern and flexible in a fast-changing world? How do you implement across current technologies as well as meet potentially outdated compliance, documents retention or security standards? How do you protect data in a cloud based hackable realm with hackers getting smarter and faster every day? These are fundamental questions not easily answered and large companies don't often like to move quickly when it comes to overhauling critical systems. Implementation will increase pace over the coming 12 months as adopting AI moves form optional to necessary to compete in a modern marketplace. This should drive an accelerating implementation and expansionary cycle. Not only will companies continue to increase profits, increase margins, and reduce headcount due to AI efficiencies, but it should drive earnings growth for tech and AI adjacent companies. Individual enterprises benefit from higher efficiency; multiple industries will benefit from growth of AI usage. We are already seeing this trend happening as companies are slowly reducing back-office headcount while at the same time increasing profit margins and employee productivity.

Capital Expenditures Anticipated to Grow Faster Driving Future Economic Growth



Source: https://am.jpmorgan.com/us/en/asset-management/institutional/insights/market-insights/market-updates/on-the-minds-of-investors/is-the-ai-capex-boom-signaling-buy-or-diversify/

AI matters beyond technology. AI Capex (Capital Expenditures/spending) is anticipated to hit $342B from JUST 5 hyperscalers (META, GOOGL, MSFT, AMZN, ORCL), up 62% y/y from last year. This means AI expenditures could contribute 1.1% to GDP growth alone. The pace of capex has also continued to increase- not only are we spending more money on this AI arms race, but we are increasing the amount we spend at an exponential rate. No tech company wants to be behind; so, it's a race to buy chips, build capacity, and train models. This growth is vital to the USA's economic expansion and desire to bring back tech manufacturing and fabrication to support domestic supply of highly sensitive chips and servers. These chips are needed to power the massive computing power needed to run and manage the data behind AI. Building data centers means construction and jobs, though operating data centers tends to be employee-light. The AI Data center value chain includes multiple industries and companies:



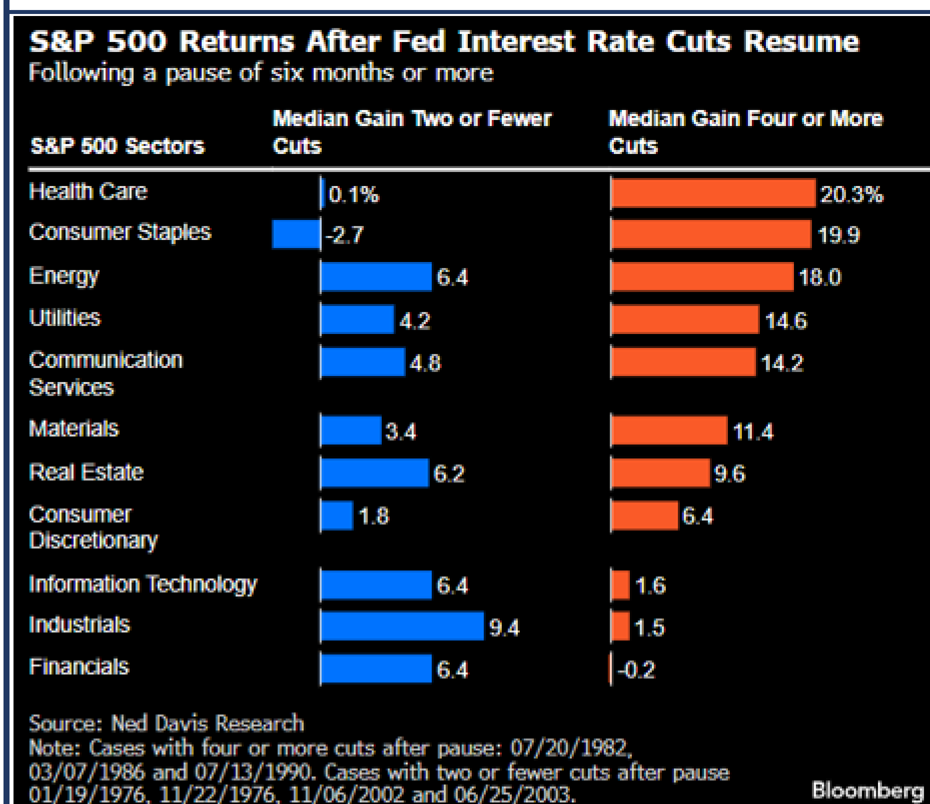
There is risk to this trend though; risk that, similar to the tech bubble in the early 2000's, AI will fail to generate the revenues we think will from the companies we think it will. So far there are a lot of promises and future talk, but companies will need to start monetizing these AI products and implementing them, not just making vague future commitments. There is risk in this fast-moving world, there will be many losers and only a handful of winners as technology eats the opportunity too quickly for others to react. Or we have another DeepSeek moment and something newer, faster, better, and more importantly cheaper comes along to change all the current expectations. AI moves at light speed; you need to be prepared to evolve as well.

Here Comes the Fed- Rate Cuts 101

The Fed has a dual mandate from Congress, set by the Federal Reserve Act in 1913, empowering it to conduct monetary policy, "so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Thus, the Fed is concerned with employment and inflation, controlling both by setting benchmark rates. Sticky inflation remains a concern, as nobody wants a repeat of the 1970's and 1980's with bouts of high recurring inflationary periods and stagflation. But it's not inflation that is the big worry right now, it's the labor market. Unemployment, currently at 4.3%, has been in a steady, mildly rising upward trend the last 2 years, coming off lows of 3.5-3.6% in Mid-2022. There are great divides in types of employment with sectors such as services and health care being extremely strong while manufacturing has continued to struggle, as well as geographic availability of jobs vs. people who are willing and able to do those jobs. This sluggish job market has the Fed moving to a more accommodative stance and likely cut 2 more times in 2025, and possibly 3-4 more in 2026 depending on how healthy the economy is at that point in time.

Rate cuts, especially rate cuts without a recession, are historically very bullish for stocks.

Rate Cuts Help Almost All Sectors



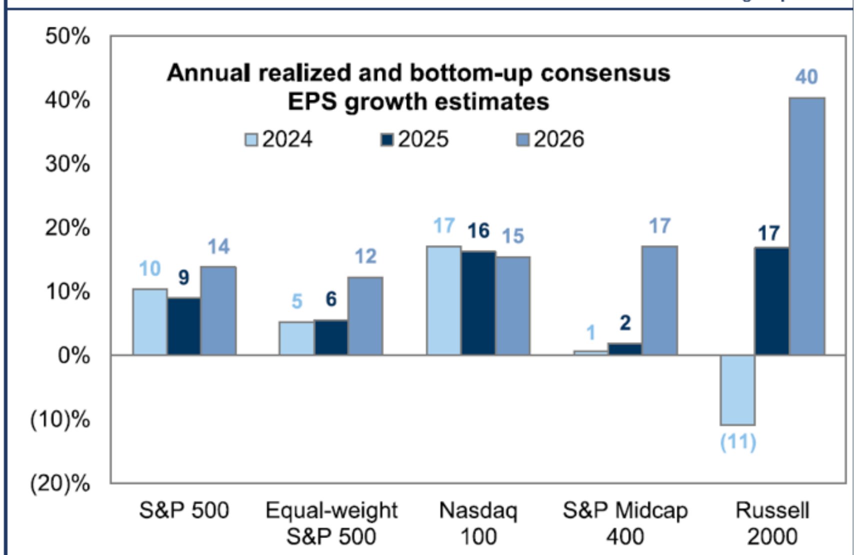
Source: *The $14 Trillion US Stock Rally is Seeking a Fed Cut Playbook.* By Jess Menton, Bloomberg LP 9-13-25

We believe this will be further stimulus for stocks to continue to rally, providing lower debt costs and a stronger economic backdrop to drive further earnings growth.

Profit Growth + Margin Expansion= Rally

There is an old saying *Fast, Cheap, or Good: Pick Two*. Right now, the markets have decided to pick fast and good, but definitely not cheap. By any measure the market is expensive. Right now, The S&P 500 is trading at a 22.6x Forward P/E about 1.7 standard deviations above its 30-year average of 17x. However, multiples historically never kill off a bull market. The index is dominated by some very expensive tech companies as multiples across the index range from below 10x up to above 100x (TSLA carries a 248x forward P/E). Tech and growth stocks have always been pricey, as well as average market multiples have been trending more expensive over time. But to us, we don't think this is the most important statistic to be looking at, we feel investors should be considering profit margins and trajectory as well as earnings growth as the 2 main indicators for market health at this point in the cycle.

Realized and Consensus EPS Growth Estimates 2024-2026. Room For Market Growth Via Earnings Expansion



Source: Goldman Sachs US Weekly Kickstart 9-19-2025 by David J. Kostin Et All. Pg. 15

FactSet Also foresees Earnings and Profit Margin growth:

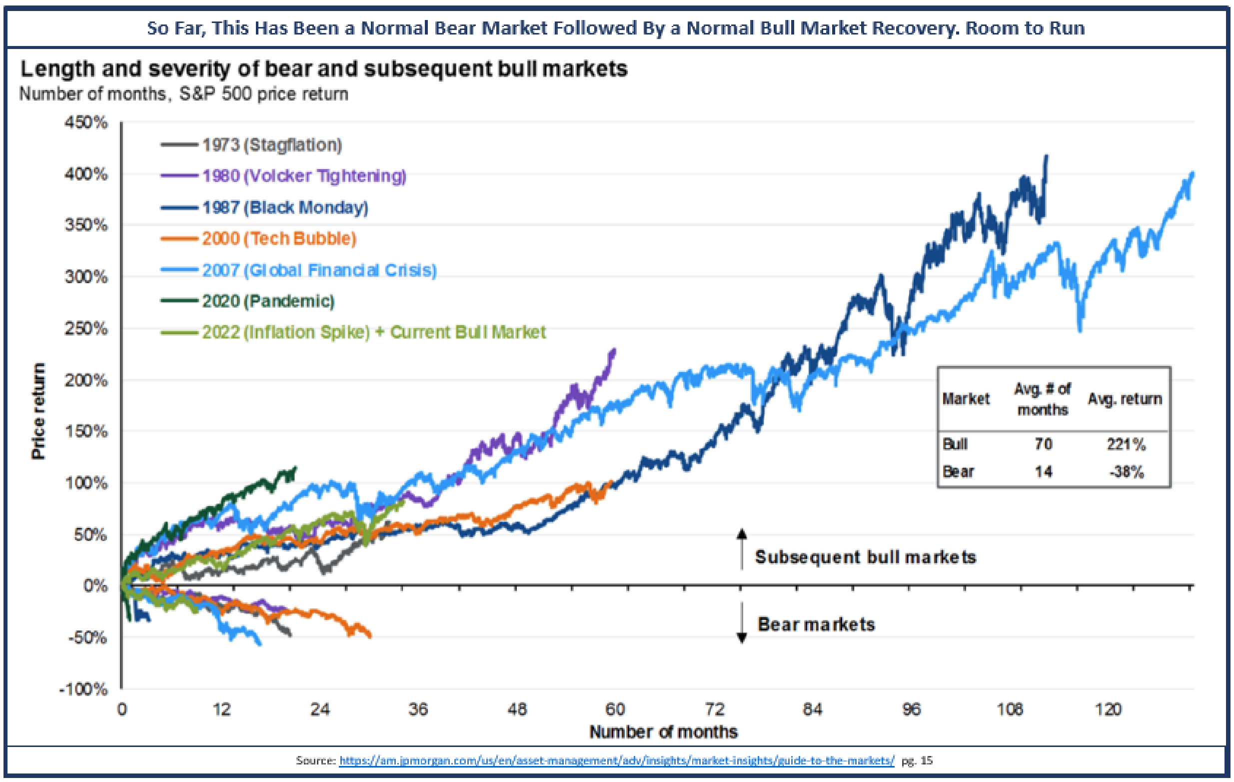
- 2025 EPS estimate 268.83, 10.7% growth
- 2026 EPS estimate 304.59, 13.7% growth
- Current Q3 net profit margin is 12.7%, above the average of 11.7%
- Expectations for further margin expansion led by Utilities and Technology
- Gross profit margin expected to grow slightly in Q3 from 34.33 to 34.59

https://www.factset.com/earningsinsight

It is extremely rare that markets would shift from a bull market to a bear market in a period of earnings growth and profit margin expansion. Those 2 indicators, which are expected to continue to grow in Q4 and 2025, mean companies expect higher revenue and more efficiency generating that revenue, thus leading to higher profits and cash flow to distribute to investors or reinvest in their businesses. In Q2, companies paid $165.16B in Dividends and spent $234.57B on stock buybacks, a shareholder yield of 3.15%. Its anticipated almost 1 trillion will be spent on share buybacks as companies look to provide value to shareholders beyond dividends. Buybacks are supportive of the market and market prices, adding to demand for shares. So, while the market as a whole is not cheap, it is being driven by strong underlying profit growth, solid fundamentals in cash flow and revenue trends, and accommodative policies that are supportive of future shareholder gains.

History Is on the Side of the Bulls

Uptrends begat more uptrends, momentum brings more momentum and bull markets persist longer and higher than many feel rational or possible. When we look back at other historical bull and bear markets, we realize this has been nothing but a normal rally off a normal bear market. Nobody would be surprised with some volatility, or some sort of 5-7% pullback, but the technicals, fundamentals, and historical precedent all point to further room for this market to run. The average bull market lasts about 70 months; the bear market of 2022 bottomed in October putting us approximately 36 months into the current bull run.



Bear markets are significantly shorter, though often more intense and difficult, than bull markets. Historically speaking, we are in the middle innings of the current bull market run and even on a percentage gained basis, are not outpacing other historic bull market recoveries. As previously mentioned, we are entering a period of a more accommodative Fed that is easing, along with stimulus from fiscal policy enacted this year. The OBBB (One Big Beautiful Bill) likely provides approximately $150B in consumer support in early 2026 due to tax cuts or rebates including higher SALT deductions, no tax on overtime, no tax on tips, 100% depreciation, and others to name a few. It's estimated that 2026 tax refunds jump to $518B up 44% from the $359B in 2025- the bulk of that likely getting plowed back into the economy via consumer spending or business investment. So, your fiscal and monetary stars are aligned to help stimulate, along with growing earnings and profit margins give support to this market powering higher in Q4 and beyond. Hard to argue the catalysts are not there for more upside.

While we feel there is a strong case for this bull market to continue in Q4 as well as 2025, there are certainly multiple risks lurking. The labor market could roll over hard, inflation spikes as businesses pass on tariffs, the Fed doesn't cut enough, or we enter the dreaded era of Stagflation- all are events that could derail equities. Or if AI turns out to be a dud and all this anticipated capex spending becomes a myth causing less expansion and economic activity than predicted. We could even see more policy uncertainty with China, India and Russia leaning in towards each other and the US and its European allies slapping large sanctions and tariffs on them. Or we could get a plain vanilla recession and economic slowdown as the USA finally succumbs to the uncertainty, hiring stops, expansion stops, and US incomes and spending dry up. There is always the possibility of a negative outcome, or a black swan event that drags us all down into a bear market. Possibility does not make it a probability.

We point out that the markets have dealt with significant policy uncertainty this year and managed to rally despite it. Tariffs and trade agreements continue to be difficult for long-term planning, as well as the high likelihood more of the tariff costs get passed on in Q4 and 2025 as companies ease in higher prices to protect profit margins. If I had to bet what kills off this bull market, it's policy error- policy almost always kills off a bull market. It could be Fiscal (tariffs, trade wars, Medicare/Medicaid cuts, government shutdowns) or it could be Monetary (the Fed is too slow or moves too fast causing inflation to reignite and a backtrack to raising rates). While I don't fear valuations per se, I do fear the uncertainty of policy will catch up with the market. Uncertainty slows growth, pauses business decisions, and can change consumer spending patterns and generally is headwind to profit growth. So far, this market has successfully climbed this wall of worry (and it's been a doozy of a wall this year). But if you look at gold steadily climbing towards $4,000, it's a sign that hedging costs are rising as investors worry about the US, the US Dollar, inflation, and what might still be coming down the pipe policy wise.

Real Purchasing Power of $1.00 USD Has Continued To Erode

Source: https://www.visualcapitalist.com/then-vs-now-1-dollar-buy-you/

For now, the bull case outweighs the lurking risks. And to keep your long-term purchasing power, investing in stocks is crucial to maintaining the real value of your portfolio. The siren song of safety in a CD or money market must be weighed with the real return potential.

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