

*Third Quarter  
Market Update  
October 2025*





# Q3'25 Market Performance, Key Drivers, & Go-Forward Outlook

*“In the short run, the market is a voting machine, but in the long run, it is a weighing machine.”*

*-Benjamin Graham*

Warren Buffett’s mentor, Benjamin Graham, famously said that in the short run the market is a voting machine, but in the long run, it’s a weighing machine. Over shorter periods of time, publicly-traded stocks are subject to investor sentiment, herd behavior, and the associated upside and downside volatility. Over the longer-run, as the pendulum swings back from the extremes of euphoria and despair, back to a more ‘normal’ environment, the intrinsic value of securities eventually surface. We think the recent run in AI related stocks has benefitted from excitement around a revolutionary technology that will shape our lives for years to come. However, it remains to be seen if many of the businesses that have seen their stock prices soar ever higher can generate revenue and profits commensurate with their valuations.

In the third quarter, U.S. equities generated a total return of 8.2%, led by enthusiasm around AI. International Developed and Emerging Markets generated total returns of 6.0% and 10.5%, respectively. The U.S. Aggregate Bond Index generated a total return of 2.0%. See **Figure 1.** for total returns in the third quarter and the year-to-date period. The table below highlights strong performance across asset classes, though it also obscures a bumpy ride, which included a ~20% draw-down in the S&P 500 earlier in the year, in large part driven by the anticipation and announcement of tariffs, before staging a rally back to an all-time-high.

**Figure 1. Market Performance, Total Return**

	3rd Quarter	Year-to-Date
<b><u>Equities</u></b>		
U.S. Total Market <sup>1</sup>	8.2%	14.4%
International Developed <sup>2</sup>	6.0%	27.4%
Emerging Markets <sup>3</sup>	10.5%	24.2%
<b><u>Fixed Income</u></b>		
Aggregate Bond <sup>4</sup>	2.0%	6.1%

Source: Bloomberg; 1. S&P Total Market Index, 2. FTSE Developed ex U.S. Index, 3. FTSE Emerging Index, 4. Bloomberg U.S. Aggregate Bond Index



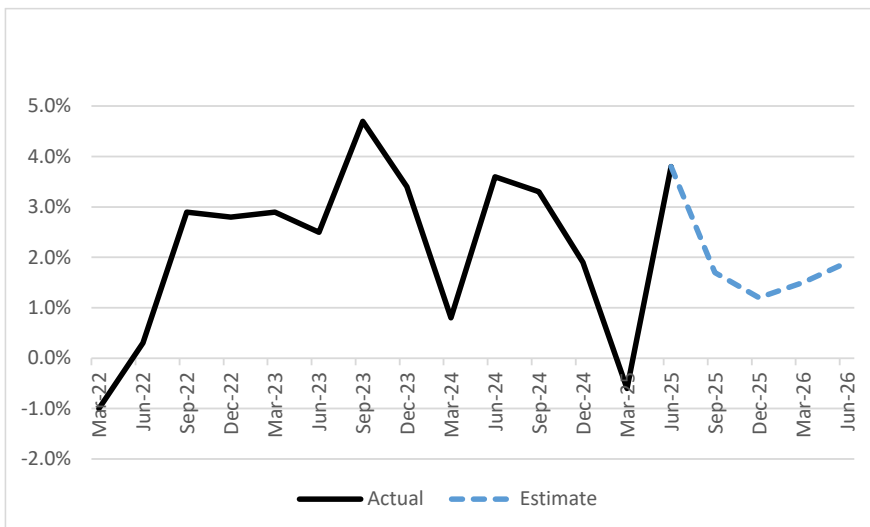
# U.S. Economic Trends

In the third quarter, Real Gross Domestic Product (GDP) is expected to have slowed to a 1.7% growth rate, and inflation, as measured by the Consumer Price Index (CPI), is expected to have picked up to 2.9%, well above the Fed's target of 2.0%. Over the next several quarters, we expect slower economic growth and higher inflation to be a key theme. See **Figure 2.** for historical and estimated Real GDP, based on consensus estimates published on Bloomberg.

There are an unusual number of cross-currents in the economy currently that should serve to counter-balance one another. On the positive-side of the ledger, provisions in the One Big Beautiful Bill Act may serve to boost economic growth, uncertainty around trade policy has abated, and AI may increase productivity. On the negative-side of the ledger, pressures include less immigration translating to less employment growth, spending cuts in the Federal government, a Federal government shutdown with an unknown end-date, and a surge in student loan delinquencies after the pandemic-era pause. To put the scope of the student loan issue in perspective, ~45 million Americans have student loan debt and a particularly high ~13% of balances flowed into early delinquency in Q2.

In regards to inflation, tariffs continue to work their way through supply chains and we expect retailers will increasingly pass along their higher costs on new inventories. Additionally, if the US Dollar continues to weaken relative to foreign currencies, imports will continue to get more expensive in dollar terms.

**Figure 2. US Real GDP Quarter-Over-Quarter %**



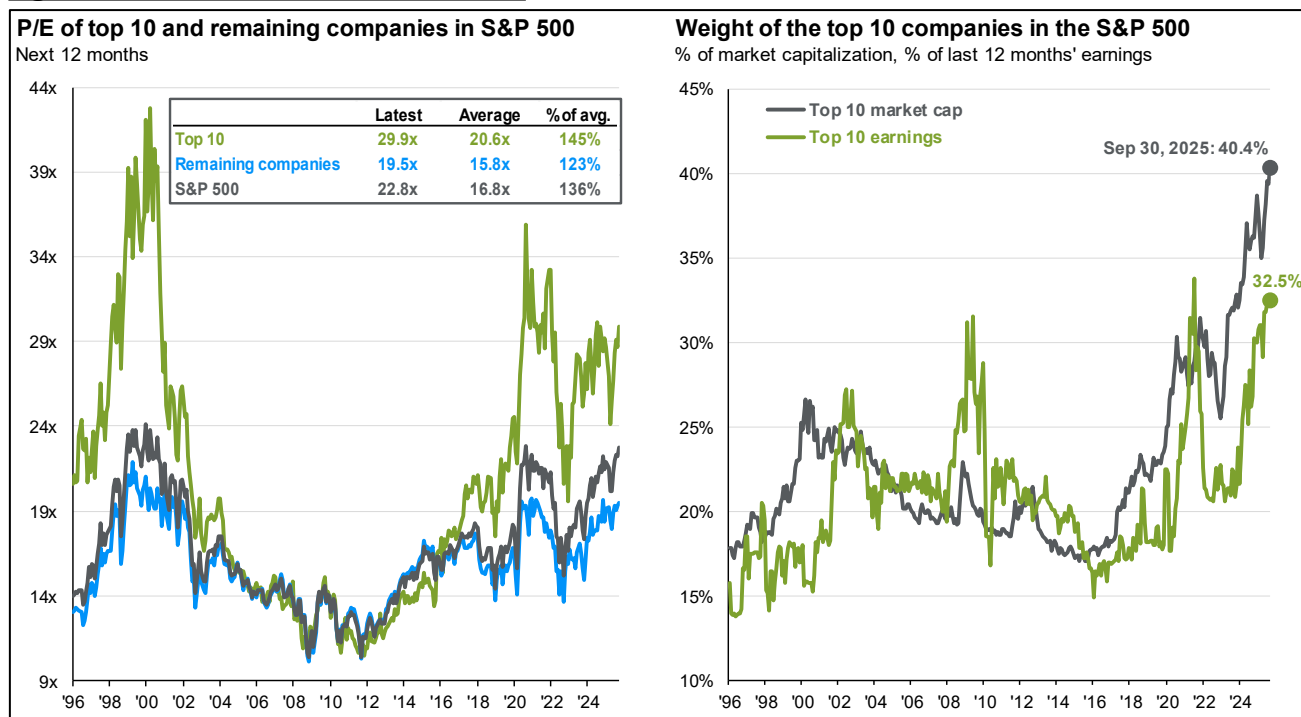
Source: Bureau of Economic Analysis, Bloomberg Consensus Estimates

# U.S. Stocks



The third quarter and year-to-date period saw the U.S. Total Stock market generate 8.2% and 14.4% total returns, respectively. Names exposed to the AI-theme have continued to be the biggest contributors. As we've discussed in prior quarterly market updates, the concentration in the S&P 500 is increasingly extreme. The top 10 companies in the S&P 500 now make up ~40% of the index. Additionally, these top 10 stocks trade at a lofty ~30x forward earnings. See **Figure 3**. In our view, investors who believe that owning the S&P 500 is a low-cost way to gain access to a basket of US stocks with diverse risk exposures may be mistaken. This problem is compounded by the fact that the top 10 companies are also relatively expensive.

**Figure 3. S&P 500 Index Concentration**



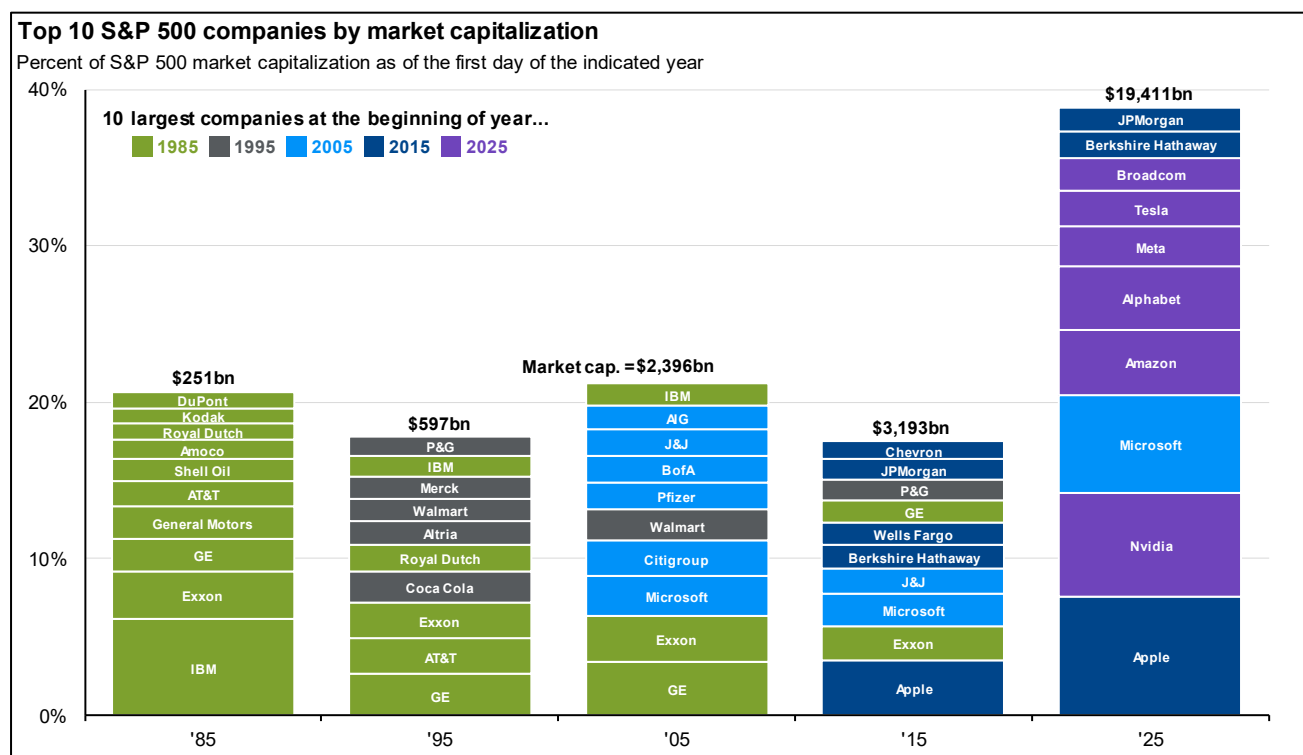
Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Forward P/E ratio is the most recent price divided by consensus estimates for earnings in the next 12 months, provided by IBES since January 1996 and FactSet since January 2022. The remaining stocks represent the rest of the 490 companies in the S&P 500, and their P/E ratio is calculated by backing out the nominal earnings and market cap of the top 10 from that of the S&P 500.

If history is any indication, it will be difficult for today's winners to remain on top into perpetuity. As an example, in 1985, the largest companies included names like Kodak, Royal Dutch, IBM, Exxon, and General Electric. As time progresses, competitive forces lead to 'creative destruction'. The lure of excess profits brings in new competitors, and new innovations make old technologies obsolete. Ideas that initially appear attractive can also lead to over-investment, leading to 'boom' and 'bust' cycles (e.g., Cisco during the Dotcom years).



As seen in **Figure 4.**, many of the current top 10 companies are major players in AI. As one might expect, the competitive environment has been increasing. For example, businesses involved in designing semiconductors are seeing increased competition from smaller players, and businesses reliant on digital advertising are seeing increased competition from the likes of Tik Tok and Netflix. Also, while large tech businesses historically required little capital investment, and as a result, were awarded high earnings multiples, to the extent this has changed, multiples should contract. With McKinsey & Company projecting \$5T to be spent on data centers to handle AI processing loads by 2030, many investors are left scratching their heads wondering how revenue and profits will be generated to make these outlays economic.

**Figure 4. Top 10 Companies by Decade**



Source: Bloomberg, Standard & Poor's, J.P. Morgan Asset Management

We think the current set-up underscores the need for thoughtful portfolio construction with a meaningful 'tilt' towards mid-cap, small-cap, and quality. While investor sentiment continues to be positive for AI-related names, as the pendulum swings back, and the 'weighing machine' re-asserts itself, we think a more diversified portfolio of names with a particular eye towards valuation will be rewarded. Importantly, we also think this approach is more in-line with sound risk-management.



# International Stocks

In the third quarter, International Developed and Emerging Market stocks generated total returns of 6.0% and 10.5%, respectively, based on FTSE indices. In the year-to-date period, they generated 27.4% and 24.2%, respectively. See **Figure 5.** for additional performance by region and for select countries. Measured in USD, which is most relevant for US-based investors, all regions and most countries outperformed the United States by a wide margin.

**Figure 5. Returns, Measured in Local & US Currency**

Returns	2025 YTD		2024		15-years Ann.
	Local	USD	Local	USD	
<b>Regions</b>					
U.S. (S&P 500)	-	14.8%	-	25.0%	14.6%
AC World ex-U.S.	18.0%	26.6%	13.2%	6.1%	6.6%
EAFE	14.2%	25.7%	11.8%	4.3%	7.3%
Eurozone	18.5%	34.4%	10.3%	3.4%	7.6%
Emerging markets	25.0%	28.2%	13.7%	8.1%	4.4%
<b>Selected Countries</b>					
Japan	13.8%	21.1%	21.2%	8.7%	7.5%
UK	17.5%	26.3%	9.5%	7.5%	6.3%
France	10.3%	25.2%	1.8%	-4.6%	7.7%
Canada	23.2%	27.4%	23.0%	12.7%	7.1%
Germany	17.8%	33.6%	18.4%	11.0%	7.7%
China	41.4%	41.8%	19.8%	19.7%	4.7%
Taiwan	17.7%	26.6%	44.3%	35.1%	13.4%
India	3.2%	-0.5%	15.7%	12.4%	5.6%
Brazil	23.5%	40.4%	-11.4%	-29.5%	-0.5%

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management; 15-year history based on USD returns

To the extent the tech trade rolls-over, which is a predominantly US-based phenomenon, and the dollar continues to weaken, we'd expect international to outperform. International stocks do relatively better when the dollar weakens, since revenues generated overseas become more valuable after being translated into USD. Note that currencies are meaningfully impacted by interest rate differentials. If the Fed cuts rates more aggressively than other central banks, dollars would be expected to flow out of the United States, and into other currencies, leading to a further weakening of the dollar.

Additionally, even after the recent run, international markets remain much cheaper relative to the S&P 500, on an absolute basis, and relative to their own histories. Importantly, this remains true even after adjusting for industry composition. After 15-years of U.S. dominance, we believe that many investors, both domestic and abroad, remain overweight U.S. assets, and flows back into international may also provide a tailwind from a demand perspective.

# Fixed Income



The U.S. Aggregate Bond Index generated a 2.0% total return in the third quarter and a 6.1% total return in the year-to-date period. Treasury yields have declined across maturities year-to-date, albeit with more movement on the shorter-end of the curve.

As widely publicized, September saw the Federal Reserve cut the fed funds rate by 25 basis points, or 0.25 percentage points, to a range of 4.00% - 4.25%. As a reminder, the Federal Reserve has a dual mandate to pursue maximum employment and stable prices. The current environment is particularly challenging for the Fed, given weaker job growth, and inflation trending above target. Consensus calls for two more 25 basis point cuts through the remainder of the year and another two 25 basis point cuts in 2026. This implies the Fed 'stops' at around 3.0%, barring unexpected weakness in the economy. There also continues to be robust debate about Fed independence and the extent to which political pressure will push the Fed to lower rates despite above-target inflation. If this were to occur, we think there's meaningful 'steepening' risk, as longer-dated Treasuries bake in higher inflation expectations. See **Figure 6.** for 'steepening' to date and go-forward expectations.

**Figure 6. U.S. Yield Curve Steepness**



Source: Bloomberg, U.S. Treasury, J.P. Morgan Asset Management

Importantly, in order to address the risk of higher inflation and a further 'steepening' of the yield curve, we have reduced duration (i.e., interest rate sensitivity) in many client accounts. Additionally, in many instances, a small allocation to an active international bond fund has been introduced, which stands to benefit from further dollar weakness. The resulting diversification may also reduce volatility, particularly given deglobalization and greater market fragmentation. In our view, this is also particularly relevant given continued deficit spending and the resulting Treasury issuance.



As always, we continue to monitor financial markets and invest on your behalf, with a long-term orientation, consistent with the PWM investment philosophy. We continue to emphasize financial planning, and take a holistic approach to helping you manage your wealth. We consider it a privilege to help our clients reach their financial goals.

Thank you for your continued trust, and as always, we remain available to address any questions or concerns.

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