Capital Market Review
Third Quarter 2025

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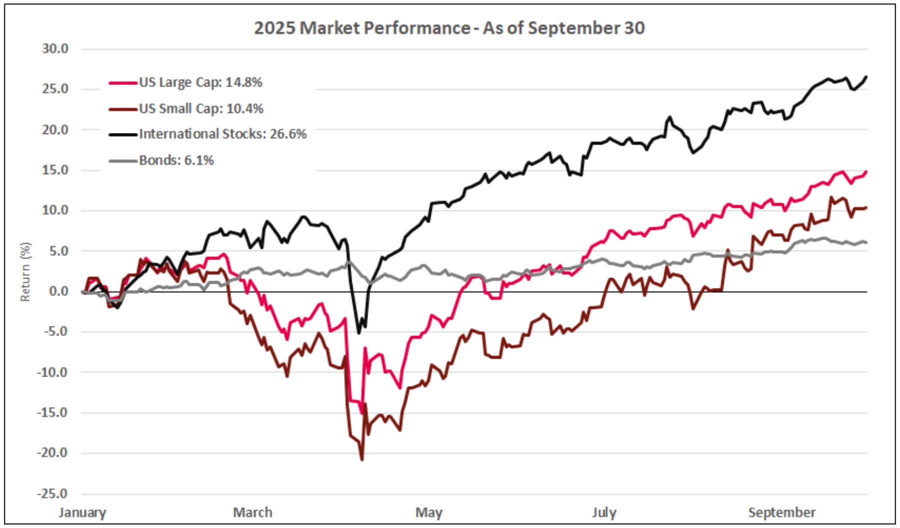
Key Takeaways

- Diversification continues to be the dominant theme, with international stocks outperforming U.S. markets year-to-date.
- The S&P 500 is being driven by a broader set of stocks, not just the Magnificent Seven. International stocks remain strong, supported by a weaker U.S. Dollar and renewed investment in Europe and Japan.
- Despite economic complexity and policy uncertainty, markets are showing strength and breadth. Staying focused on long-term goals and maintaining a globally diversified portfolio remains the most reliable strategy.

Diversification remains the theme of the year. International stocks continue to outpace their U.S. counterparts, although U.S. stocks performed slightly better than their international peers last quarter. After quite a few years of lagging returns, U.S. small-cap stocks were the best-performing of major asset classes last quarter, returning over 12%, compared to large caps returning 8%, and international stocks up 7%. Despite what might have been expected to be volatility-inducing events, markets had a very strong quarter.

The Return of Diversification

Not only are we seeing diversification work across markets, but we are also seeing the S&P 500 Index led by stocks not named Nvidia or Microsoft. Through the first nine months of the year, not a single Magnificent Seven company (Nvidia, Microsoft, Apple, Amazon, Meta, Alphabet, or Tesla) ranked among the top 50 performers. While these seven companies continue to significantly impact index returns due to their size, strong performance from other sectors and industries could potentially mark the beginning of a shift away from large-cap technology.

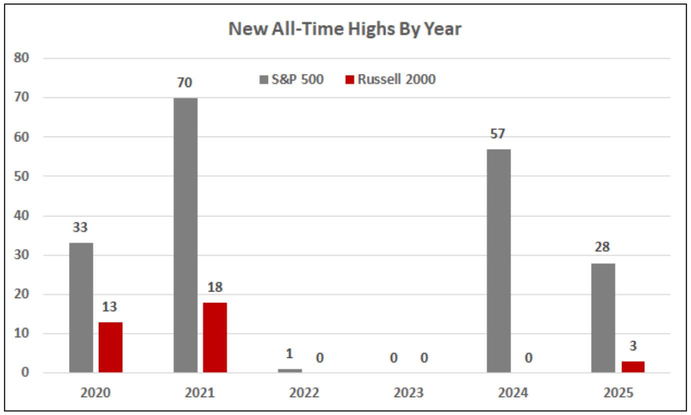


International markets remain strong performers in 2025. Although U.S. stocks performed better last quarter, international markets have continued to outpace other major indexes so far in 2025. As we noted last quarter, the weakening U.S. Dollar is a factor driving international returns. However, that is not the only catalyst. After years of underinvestment, Europe is finally investing in defense and infrastructure. In Japan, companies have held cash on their balance sheets for decades, resulting in minimal, if any, growth. Now, after years of corporate governance reforms, Japanese management teams are focusing on longer-term growth and returning value to their shareholders. While the Dollar's weakness has had an impact on returns this year, we're hopeful these structural changes are the beginning of a longer-term growth trend in overseas markets.

Even small-cap stocks showed a strong performance during the quarter. Following several years of underperformance, the Russell 2000 Index used Federal Reserve Chair Jerome Powell's August comments, which all but guaranteed a September rate cut, as a much-needed catalyst. After the Fed followed through, the Russell 2000 Index went on to hit a new all-time high for the first time since 2021. For comparison, the S&P 500 Index reached 23 new all-time

Continued

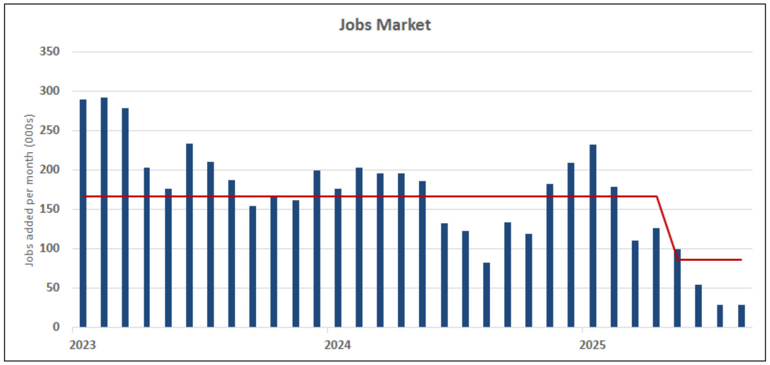
highs during the third quarter alone. Small caps have a lot of ground to make up relative to large-cap stocks; hopefully, like international markets, this is the beginning of a longer-term growth trend.



Economic Updates

Rarely is the economic outlook straightforward, and of course, that remains the case today. The Federal Reserve lowered short-term interest rates by 0.25% last month to "shift the balance of risks" rather than responding to immediate downside concerns. The labor market is a mixed picture, and of course, the ever-evolving tariff landscape adds to the uncertainty.

The labor market was a key factor in the Fed's decision to lower interest rates last month. While the unemployment rate remains relatively stable at 4.3%, increasing slightly from 4.0% at the start of the year, job growth has slowed significantly, which has been seen in the recent monthly jobs reports. After averaging about 185,000 jobs added per month from 2023 through the beginning of 2025, growth has slowed to around 30,000 per month during the third quarter.



A decline in immigration is a key factor in the slowdown of the jobs market, as fewer people are seeking employment. According to The Wall Street Journal, in 2024, the U.S. needed to add 166,000 jobs per month to maintain a steady unemployment rate. Now, the economy needs to add 86,000 jobs to maintain the rate. The chart below illustrates this change, with red lines indicating the required monthly job openings needed to maintain a flat unemployment rate and blue bars representing the actual three-month averages of hiring. While job growth is slowing and needs to increase, we may not need to see a return all the way to what was considered normal a year ago. However, it is unclear how having fewer available workers will affect other parts of the economy.

Inflation remains a concern, although not to the same extent as in 2022, as it is still above the Fed's comfort zone. Recent shifts in trade policy, including new tariffs on strategic goods and retaliatory measures from trading partners, have the potential to increase input costs for manufacturers and raise consumer prices. As these changes make their way through the economy, inflation is likely to remain stable to slightly higher, presenting a continued challenge to consumers and policymakers.

Looking Ahead

The economic backdrop is anything but simple. The Fed's recent rate cut signals a shift in tone; the labor market and inflation data present a challenging picture. Tariff changes, global political dynamics, and a U.S. government shutdown add further layers of uncertainty. Still, amid all this, markets have continued to climb to new highs, supported by underlying fundamentals and a broader participation in growth.

Amidst uncertainty, it only reinforces our belief in maintaining a globally diversified portfolio. Depending on the article you are reading or the commentator you are watching, there are going to be a variety of opinions on which direction the economy and markets go from here. Even during the best of times, when all data is coming in better than expected, someone will still be predicting an upcoming recession. Rather than getting caught up in every opinion or every tariff headline that may or may not come to fruition, we remain consistent. We look beyond the near-term uncertainty to the long-term prospects a strategic, diversified portfolio can deliver.

10/2025