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The Colors of Fall

Autumn has arrived with its punchy fall colors and crisp winds out of northwest up here in New England.

Hopefully you were able to set aside some happy moments with family and friends this summer, creating memories and great stories to share at a future date.

Meanwhile the financial markets did their part over the summer months. The S&P 500 advanced (on a price basis) about 8.2% from June 2nd to August 29th, appreciating from 5911.5 to 6472.75. We know we have some picky friends out there that will point out that we didn't go all the way to the autumnal equinox, the official end of summer. The return through that date, September 22nd, was even higher, closer to 13.6%.

The favorable trends driving the market in the second quarter continued in the third: a resilient economy with low unemployment and receding inflation, solid corporate earnings with a powerful tailwind from AI related spending and favorable macro developments as tariff fears have eased, and the Federal Reserve has been cutting interest rates, with more anticipated. Fed funds are currently at 3.75% with two more cuts of 25 basis points expected over the next 12 months, suggesting we could see that rate closer to 3-3 1/4%. Fiscal stimulus in Asia and parts of Europe has lifted sentiment for overseas investments.

The table below shows third quarter and year-to-date results for some key benchmarks. The widely watched S&P 500 gained an impressive 8.12% in the quarter while the Russell 2000 index, an indicator of small and mid-size companies, posted a 12.4% gain. Small and mid-size companies have trailed considerably in recent years compared to their larger brethren in the S&P 500, and so this response



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from smaller companies in the third quarter was encouraging as it indicates a potential broadening out of the market gains.

The often-overlooked overseas markets continue to shine as the MSCI All-Country World Index ex-US rose 7%, totaling a near 27% gain year-to-date. International markets remained positive during the April dip US markets experienced and have provided nice diversification for balanced portfolios this year.

	<u>3Q 2025 (%)</u>	<u>YTD 2025 (%)</u>
Dow Jones Industrials	5.67	10.47
Standard & Poor's 500	8.12	14.83
NASDAQ Composite	11.41	17.93
Russell 2000	12.39	10.39
Russell Mid-Cap	5.33	10.42
Russell 1000 Growth	10.51	17.24
Russell 1000 Value	5.33	11.65
Barclays Capital Govt./Corp. Bond	1.91	5.93
Barclays Capital 5 Year Municipal Bond	2.19	4.51
MSCI AC World ex US	7.03	26.64

Source: Morningstar

So where does this leave us today? Our Chief Investment Office (CIO) notes that the MSCI All Country World Index is currently trading at close to 19 times forward earnings, which is roughly a 30% premium to the 20-year average. The S&P 500 is currently priced at 23 times forward earnings, which is at the higher end of historical valuations.

These higher-than-average prices are justified, in the CIO team's view, based on corporate earnings that continue to deliver growth of 7-10% on average, and investors are optimistic about the tailwinds from lower interest rates, business friendly tax policies and deregulation that typically boost stocks. There is huge investment in AI related infrastructure and power needed to meet future demand, and businesses are investing in reshoring manufacturing capabilities with various state and federal incentives.

The CIO has raised its S&P earnings per share growth forecast to \$275, or 10% higher, for 2025 and \$305 per share, or 10% growth, for 2026, and upgraded its rating on US and global stocks to attractive from neutral based on an improving outlook for global stocks and a view that these secular growth drivers will persist. The new target for the S&P 500 is 7,300 for summer 2026, vs. 6,800 today, which is around 7% higher and in line with expected earnings growth.

The valuations at the index level don't tell the whole story of how large the biggest companies have become. For context, the weighting of technology companies in the global stock index, MSCI All Country World, climbed from 11% to 27% in the past 20 years. Nvidia recently became the first company whose market capitalization passed \$5 trillion, and there are 10 companies listed in the US with market values of over \$1 trillion. These are very large companies. Google alone reported over \$100 billion in revenue in the third quarter.



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The average price to earnings ratio for the Magnificent 7 stock is close to 30 times forward earnings and this group of companies accounts for 37% of the S&P 500 market capitalization. This means the prices for those companies lift the entire index's price. Understandably investors draw parallels to the dotcom era when a potentially game changing technology dominated the headlines. Our analysts point out an important difference, that the NASDAQ 100, a barometer for technology stocks, were trading at over 80 times forward earnings during that period. So while US technology stocks are pricing in strong growth in today's market, we are far from the eye watering prices and slimmer profits of that period.

We are in the early innings of a potential technology shift on a similar scale to the advent of the Internet, and given the enormous amount of investment, there will be winners and likely a few losers as well as bumps in the road. It is difficult to predict when these bumps may occur, as well as their causes.

The best course of action is generally to stay invested and balance these promising long term growth companies with other investments that are less dependent on higher expectations. You want to include investments that do well even if the current consensus views do not hold.

As an example, two value managers we have long considered partners have a collection of high-quality, attractive stocks that are priced at around 12-14 times forward earnings in today's market. This is close to a 40% discount to the S&P 500. The outcome of these investments are not dependent on the fate of high-flying chip companies like Nvidia, and an investor's portfolio would do well to have exposure to both.

This year so far has been a reminder that accepting some price volatility is part of the price of admission for investing in stocks, as we saw when the sharp April dip was followed by a strong rally. Investors who sold in April or June missed the bounce back.

Bonds have shined this year and offer better return potential with interest rates moving lower than money markets, CDs or other cash equivalents. Tax free municipal bonds still provide attractive after tax yields above taxable bonds, particularly for higher income investors.

There are many crosswinds and nascent trends in this country. In this bastion of capitalism we note with interest the results of recent voting, particularly in New York City where a democratic socialist, Zohran Mamdani, has won the mayoral race. As far as we know this is a first. He wants to freeze rents, open government run markets, and of course tax the rich. He is basically a communist. All of this bears watching.

As always thank you for the trust you place in us. We hope the rest of the year brings you happiness, joy and good returns.



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