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Q4 Outlook: *The Great Reordering Continues*

Friend of Clear Harbor,

If ever there was a moment when markets “climbed a wall of worry,” this is one. Investors face a complicated backdrop as we enter the final quarter of 2025: lower inflation and resilient corporate earnings on one side, and shifting trade regimes, mounting fiscal concerns, and persistent geopolitical volatility on the other. All while market indices notch new highs and key P/E multiples keep expanding.

Yet this feels different from other periods in which markets trended higher amidst uncertainty. It is crucial today that we go beyond the ordinary rigors of parsing conflicting economic data and earnings statements, and confront in a clear-eyed way the tectonic shifts underway in the digital economy, the structure of global manufacturing, and the geopolitical order.

The digital economy—which has helped create the most prosperous middle class in world history—seems to be at its own precipice forced by astonishing advancements (driven by equally astonishing capital expenditures) in AI. However, AI’s ultimate impacts on work, life and society remain impossible to predict. Whether it will unleash a new period of growth and advancement that lifts all boats, or primarily serve to enhance corporate margins at the expense of employment and income across a wide range of professional fields and industry sectors, will be a story only the coming years can tell. For companies here in the U.S., new visa fees for skilled workers and new questions about how much return we can reasonably expect from such extraordinary investment further complicate this story.

At the same time, trade, fiscal, and military alignments are shifting in interrelated and foundational ways. U.S. trade barriers stand at their highest in several generations, which is reshaping supply chains and price dynamics even as legal challenges to tariffs continue. NATO’s cohesion is being tested at a delicate moment for global security, while populism, distrust in institutions, and political disorder appear to be secular forces gaining momentum around the world. Longstanding “non-aligned” or “switch-hitting” nations such as India and Turkey are being forced to choose clear sides as Europe and the U.S. ramp up pressure on Russia’s oil exports over its terrible grinding assault on Ukraine.

For most of my career, questions of political and military realignment have primarily been relevant to investment decisions in narrow terms, such as assessing tail risks for foreign energy production and associated pricing and economic impacts. But today, many such global crosscurrents have real-time, real-world implications for a much broader set of capital allocation considerations. Even here at home, the Supreme Court has agreed to hear cases with the potential to redraw the boundary between legislative and executive authority after several decades and presidential terms in which the pull of executive authority from Congress seems increasingly obvious.

I mention these realities not to focus on the political realm but rather to highlight the gravitational pull that government seems to have and the increasing sway that these forces have over ever-increasing swaths of the U.S. economy. In all these respects, the “Great Reordering” we highlighted in our Q3 commentary remains well underway.

The Macro Backdrop: *Parsing Distorted and Conflicting Signals*

While the pace and sweep of global change has created tremendous uncertainty, certain signs of regional economic progress are in fact increasingly clear—and some are coming after many decades of disappointment. European defense integration and self-reliance are advancing, Japanese corporate reforms are bearing fruit, and renewed opportunities are salient across select emerging markets.

In the U.S., inflationary pressures have eased dramatically since the Covid-era peak of 2022. September’s CPI registered at 2.9% year-over-year, up from a low of 2.3% struck in April and a significant decline from the cycle peak of 9.1% seen in mid-2021.¹ But beneath that aggregate, the consumer experience remains deeply divided. Everyday essentials—from insurance and healthcare to food, autos, and mortgages—remain elevated.

- **A Tale of Two Consumers**

While declining gasoline prices, moderating rents, and normalized supply chains provide relief, the reality for consumer spending—representing some 70% of the economy—is a bifurcated base. Upper-income households continue to benefit from substantial financial assets. Money market funds alone are estimated to generate an estimated \$150 billion in income this year. These households now account for more than half of all retail spending, up from one-third just a few years ago.

Lower- and middle-income households, by contrast, remain constrained. Credit card APRs north of 20% and auto loans near 9% weigh heavily, while delinquency rates, though improved from 2023 peaks, remain well above pre-pandemic norms. This “tale of two consumers” will be central to the trajectory of aggregate consumption into year-end and throughout 2026. It will also be tested amid signs of substantial weakening in the labor market, whose previously reported momentum was recently downgraded by more than 900,000 jobs.

¹ All market and economic figures are per Bloomberg LP as of market close on September 29, 2025.

- AI: “Jobless” Economic Growth Ahead?

The impact of job losses on economic growth and especially corporate profitability in the coming years may surprise us. Optimists point to the potential for Artificial Intelligence to create computer-generated assistants—some of which could be actual robots—that could increase economic output without adding additional fixed labor costs. If the AI revolution evolves in a manner that dramatically boosts productivity for businesses, we could see corporate margins hold up well along with broader metrics of economic growth even as the employment picture and consumer spending weakens. This would represent a meaningful break with typical past trends, and provoke new conversations around how we interpret and apply labor data in discussions about everything from the economy and investing to overtime rules, “re-skilling” and unemployment insurance.

- Conflicting Data

With that said, there is currently cause for macroeconomic concern beyond consumer spending and employment. Even the latest GDP release, which revised Q2 2025 growth upward to a healthy-sounding 3.8%, may overstate the underlying strength of the economy. Recent shifts in tariff and immigration policy appear to have distorted the data, contributing to an unusually large inventory build while simultaneously suppressing imports relative to exports. These crosscurrents suggest that a portion of the reported acceleration in Q2 reflects temporary policy-driven dislocations rather than a durable improvement in domestic demand.

- A Complicated Housing Picture

Other anomalies within the economy may be taking hold. For example, we are very focused on the state of U.S. housing, including prospects for falling mortgage rates and their impact on housing prices. While lower mortgage rates have historically augured higher prices, this time may hold some unusual nuance.

A majority of mortgagees today have locked in rates below 4%, or approximately 2.5% lower than they would find if they moved and had to finance a new home tomorrow. This leaves many owners stuck in their homes, effectively disincentivized from relocating or “buying up” as their households expand—and constraining overall liquidity for the entire housing market in the process. If new mortgage rates begin to converge with these legacy rates, more homeowners would feel freer to sell, helping to unjam this “shadow inventory” and provide some pricing relief for new buyers.

Indeed, whether because of the factors noted above or from simple buyer exhaustion, many residential markets have recently ebbed from multi-year highs. The offsetting and more promising factor for resuming gains in home prices is that household formation has far outpaced new home building over the last several years. While I suspect we will need to see prices soften a bit further before we establish a floor, there does exist natural pent-up demand for housing which should continue to support residential housing prices in the years ahead.

Corporate Earnings: *Resilient, With Signs of Increasing Sector Divergence*

The Q3 earnings season exceeded expectations with S&P 500 earnings rising 10% year-over-year, ahead of consensus forecasts for 5%. Revenue growth averaged roughly 6%, reflecting still-solid nominal GDP. Technology and Communication Services led the way, powered by sustained AI infrastructure investment, while Consumer Discretionary companies benefited from resilient demand among higher-income households.

Conversely, Real Estate and Consumer Staples remained under pressure from financing costs, sticky input prices, and excess supply. Healthcare—while still out of favor—may be showing signs of bottoming and potentially rebounding due to a combination of historically low valuations, lower interest rates sparking capital flows to a historically capital-intensive industry, and a shift in winds down in Washington, D.C. which would favor domestic biotech over foreign firms.

Consensus points to mid-single-digit earnings growth in 2026, though expected dispersion across sectors is widening. We do see opportunities across select energy producers focused on natural gas and commercial solar. We also see the financial sector benefitting from lower interest rates and an acceleration in M&A activity.

Equity Opportunities: *Balancing Stretched U.S. Valuations with Global Tailwinds*

As we move into the final quarter of 2025, the global equity landscape remains characterized by diverse forces: stretched valuations in the U.S., fiscal expansion in Europe, and structural reform in Japan. Each region offers distinct opportunities and risks that merit consideration within a diversified portfolio.

United States: Will Returns on AI Investment Justify Current Multiples?

U.S. equity markets have delivered strong gains in recent years, led by mega-cap technology and communication services names tied to artificial intelligence and digital infrastructure. In fact, technology has grown to represent approximately 34% of the S&P 500 Index—effectively matching the all-time high-water mark set back in March 2000 at the peak of the Dot-Com bubble. This dominance by a single sector explains how a small handful of names has pushed the entire index up 14.3% YTDⁱ, versus just 9.2% for the version of the S&P 500 in which each stock carries the same weight.

Perhaps unsurprisingly after such an impressive runup in price, tech valuations have expanded: they now stand at a forward price-to-earnings multiple of 31x, versus an average 22x for the overall S&P 500. While this is well above long-term averages for the sector, it is well shy of the 48x reached in March 2000. Earnings growth for this subset of companies has been robust, and in our opinion does justify current prices for many of them.

The question is whether this pace can be sustained—and this is where opinion varies widely. Some see the AI-driven tech boom peaking soon, with less capex spend to fuel advanced chips sales than many

anticipate. Other believe we are still in the early innings of a genuine “fourth industrial revolution” whereby AI will impact our daily lives in ways that were unfathomable just a few years ago, leading to a surge in earnings growth and productivity gains for these firms and indeed the entire global economy.

In the midst of this proverbial war of ideas, we are hardly in the bunker waiting for one particular outcome. Instead, we are meeting with industry experts, reading, analyzing, and assessing the range and likelihood of various outcomes and the potential investments that still may be worthy of client capital. Elevated valuations relative to history suggest that forward returns may moderate, particularly if earnings growth slows in these index-dominating names. But if “this time is different” and we have a new technological revolution upon us, today’s elevated prices may well have room to advance further.

Much depends on the market position and strategy of individual companies, whose evaluation is a daily focus at Clear Harbor. For some, capex in this area remains strong with a runway for years of significant growth; for others, we question how the hundreds of billions being invested can generate the revenue required to reward investors.

The Nvidia/OpenAI alliance announced just this past week highlights this point. Nvidia aims to provide OpenAI with chips as well as some \$100 billion in financing over several years for data-center buildout. In both ambition and scale, this deal is one of the boldest in the AI infrastructure space. On its face, it creates a powerful alignment: Nvidia ensures OpenAI remains a core anchor customer, while OpenAI secures resources to scale compute aggressively. The question is whether OpenAI can consistently monetize advanced models at scale well enough to support such a capital-intensive infrastructure spend. If compute demand or willingness to pay doesn’t keep up, the whole structure could be hard to sustain. Whether these arrangements prove to be smart and financially sound strategic alliances or examples of financial engineering gone awry will become clearer in the quarters and years ahead.

United States: Beyond the “Mag Seven”

What about the wide world of stocks beyond the “Magnificent Seven”? The equal-weighted S&P 500 is trading at a more reasonable 17x multiple than its tech-dominated cap-weighted sibling, and U.S. small caps remain cheap on many metrics. Part of this dichotomy in valuation is a function of the disparate impact that economic ebbs and flows have on companies across other sectors. For example, core segments of the U.S. economy from healthcare and biotech to manufacturing have been on their heels for months if not years, but may now warrant fresh attention. Indeed, Q2 earnings reports suggest robust earnings growth prospects in many sectors. Some examples:

- **“AI beyond tech:”** AI is no longer just a tech story, but increasingly one that stands to lift sectors from utilities and industrials to energy and financials. The opportunities are diverse: they range from ways to power data centers, to the infrastructure and industrial technologies needed to connect, monitor and bring that electricity to market, to firms offering financing and investment products. We see the AI buildout as expanding by the day and benefiting the broader economy.

- **Industrials** within the S&P 500 have represented one of the top-performing sectors this year supported by robust aerospace performance, the AI infrastructure buildout and its associated energy needs. We see these trends, along with the expansion of the defense industry both at home and abroad, as supporting a multi-year growth spurt for earnings across the sector.
- In stark contrast to these areas of industrials, the broader **manufacturing economy** has been contracting for the last six months. Will the Administration's tariff policy settle at rates that effectively nudge domestic manufacturing of capital goods and consumer goods meaningfully higher in the quarters and years ahead? We await further data and on-the-ground activity to provide clarity on this important question, while recognizing that different areas of manufacturing vary significantly in their existing supply chain complexity, capital intensity, available domestic workforce, and other factors that can affect reshoring decisions.
- **Many U.S. banks** found a nice tailwind from M&A and capital markets acceleration this past earnings season. We see financials continuing to benefit from prospects for a more favorable regulatory environment, lower interest rates with a steeper yield curve, and increased transaction volume, including among private equity firms selling assets or entire companies.
- **Healthcare** has underperformed significantly again this year, with year-to-date earnings revisions trending downward in key subsectors. The challenges in the sector are real and many: pharmaceuticals face pricing pressures and patent expiry concerns, med tech is experiencing cost inflation and lower procedure volumes, managed care providers fear reimbursement risks.

With that said, several reasons suggest the sector could be poised for a rebound. First, at some point investors tend to shift from sectors that are clearly heavily owned into areas that are out of favor, particularly if their valuations are more attractive; in the quarters ahead, this could entice investors to rebalance their gains from tech into healthcare. Similarly, traditional defensive sectors—of which healthcare is a classic example—could prove more comforting to own if the economy should decelerate from its impressive pace of recent years. Indeed, key segments of healthcare have recently shown signs of a breakout; we are cautiously optimistic that further opportunity exists to pursue reasonable risk-adjusted returns in this area.

- **Real Estate** has underperformed and may continue to do so even as we experience lower interest rates. However, the reality is that household formation has been outpacing home building in a meaningful way—a data point that we believe suggests a rising likelihood that homebuilding activity will begin to accelerate sometime in 2026 or 2027. This is likeliest if rates trend lower, inflation normalizes, and the employment picture remains reasonably robust.

Europe: Off the Starting Blocks?

The European equity market has returned approximately 13.2% year-to-date in euro terms, with unhedged U.S. investors capturing an additional 14.5% when translating a stronger euro back to dollars. From a fundamental perspective, fiscal expansion is poised to provide a powerful boost to stocks across

the Continent. Defense, infrastructure, utilities, and industrials all stand to benefit from renewed deficit spending, much of it tied to NATO commitments and green transition mandates.

Importantly, Europe is embarking on this fiscal path from a more conservative starting point: Germany's debt-to-GDP ratio sits at roughly 65%, compared to more than 120% in the United States. While the pace of spending in Europe may be slower than Americans have pursued in response to economic duress, nominal room for expansion on the Continent is significant, and the multiplier effect could be meaningful for regional equities. Even with their strong performance already this year, we view European stocks as supported by tailwinds that should persist into 2026 and beyond.

Japan: Reforms Taking Hold

The broad Japanese TOPIX equity index has rallied by approximately 15% year-to-date; U.S. investors have captured an additional 6.7% from the strength of the yen versus the dollar. Japanese equities continue to benefit from a powerful combination of corporate governance reform, shareholder-friendly policies, and capital reshoring. Since regulatory changes and Bank of Japan policy shifts gained traction in late 2022, investors have rewarded Japanese companies for improving return on equity, boosting dividends, and repurchasing shares. We expect these trends to continue.

Moreover, rising interest rates in Japan have nudged individual and institutional domestic investors to reshore their investment capital after many decades of sending it overseas to capture higher returns. We believe this trend appears multi-year in nature, and with valuations still attractive relative to U.S. peers, we expect Japanese equities to remain a compelling allocation.

Fixed Income: *Dipping Toes into Duration More Than Credit Risk*

The U.S. bond market delivered a solid performance in Q3. The Bloomberg Aggregate Bond Index is up about 6% year-to-date, supported by yields that drifted lower (and prices that drifted correspondingly higher) across the curve. Despite a federal deficit surpassing \$2 trillion in fiscal 2025 and total national debt north of \$37.5 trillion, Treasuries remain relatively well bid compared to sovereign peers. In fact, the 10-year yield has fallen nearly 45 basis points year-to-date, even as 10-year German Bund and Japanese JGB yields have risen by 35 basis points and 55 basis points respectively.

I continue to see the benefits of incrementally extending duration in fixed income portfolios, but only gradually. To be sure, we recognize the value of allocating portions of debt portfolios to longer-dated Treasuries to protect against the possibility of economic deceleration in the quarters ahead. It would be tempting to allocate more aggressively out the curve for this reason, but stubborn inflationary pressures above the Fed's 2% target give us pause before locking in rates for too long. We continue to emphasize high-quality investment grade securities across the sovereign and corporate landscape.

Looking forward, several additional dynamics will shape our fixed income strategy:

- **Credit spreads:** Spreads remain tight, particularly in high yield. Although defaults are still suppressed, we are cognizant of the risks of economic deceleration and rising default potential in 2026, and thus remain selective in allocating to riskier credit where compensation is thin.
- **Federal Reserve policy:** With inflation still above target but the labor market softening, the Fed resumed its rate-cutting campaign earlier this month. We expect another 25–50 basis points of easing before year-end, while recognizing the reality that the future path for rates is uncertain.
- **Yield curve dynamics:** The Treasury yield curve is likely to steepen further if the Fed continues cutting short-term rates in the coming months. However, we do not subscribe to forecasts of a structural decline in demand for Treasuries should an economic soft patch or even an outright recession ensue. In such an environment, we would expect interest rates to fall (and bond prices to rise) as equities falter. But this would most likely not occur with perfect symmetry: in fact, a one-basis-point move in the 10-year delivers nearly four times the price impact of the same move in a 2-year note. Such a scenario would capture a significantly higher total return for investors holding longer-maturity Treasuries, providing them with a bigger proverbial “air bag” to protect against the likelihood of declining equities in a recessionary environment.
- **U.S. dollar dynamics:** Since its peak in late January, the dollar has fallen some 11% against a basket of other major currencies. I have often observed that currencies are challenging to predict. However, I recognize a scenario in which the Fed continues to cut rates even as the European Central Bank stays on hold and Japan continues its rate-hiking campaign—a combination of rate differentials that should incrementally weaken the dollar. With that said, uncertainty around capital flows and their relation to current U.S. tariff policy undermines our conviction in this view.

Gold: *Still the Ultimate Reserve Currency*

I often preface this discussion by reminding readers that I am not a “gold bug.” Yet I remain constructive on gold’s role within balanced portfolios. Its allure is not based on dividends or coupons, nor on industrial demand, but rather on its five-thousand-year track record as a store of value and strategic hedge. Unlike fiat currencies, gold cannot be printed.

In a world of eroded trust in government, persistent fiscal deficits, and the declining purchasing power of major currencies, gold remains a powerful diversifier. It has returned 45.7% year-to-date and delivered an average annualized return of 12.7% over the past decade, with little correlation to either equities or bonds. For investors seeking balance and resilience, gold still deserves a place at the table.

Alternative Investments: *Proceed...With Caution*

Alternative investments continue to serve an important role in client portfolios. From merger arbitrage to statistical arbitrage to catastrophe bonds, these exposures can provide ballast to portfolios otherwise dominated by stocks and bonds. But their role must be tailored: the needs of a 50-year-old in peak earning years differ significantly from those of a retiree seeking stable income. Our responsibility remains to align allocations with financial objectives and each client's definition of "peace of mind"—all while taking care to call out high fees, lengthy lockup periods, and unusual facets of specific opportunities that must be taken into account.

Secular Themes—for Q4 and Beyond

As we look beyond the immediate market environment, several structural forces remain front of mind:

- **AI-driven productivity** is in its early innings, reshaping industries unevenly but profoundly.
- **Labor dynamics** will be influenced by aging demographics and immigration policy, impacting both wage pressures and broader inflation paths.
- **Electricity demand** is surging as AI, EVs, and industrial reshoring collide, driving unprecedented infrastructure investment in solar, storage, and transmission.
- **M&A activity** is reviving as regulatory headwinds ease, with technology, energy transition, and financials at the forefront.
- **Tokenization of assets** via blockchain and other digital technologies remains nascent but could democratize ownership and broader capital market structures.
- **China's export of deflation**—in effect, pushing goods onto its regional neighbors at uneconomic prices in an effort to maintain domestic employment—is reshaping global trade dynamics, pushing EM currencies higher and possibly bolstering capital markets in these regions.
- **Geopolitical fragmentation and deglobalization** is poised to foster ongoing demand for gold and reduce appetite for U.S. Treasuries in some quarters even as U.S. issuance continues to rise. As countries trade less with one another, the need to manage their currencies through the purchase of dollar-based or euro-based fixed income declines. Many countries—especially U.S. adversaries such as China and Russia—may prioritize other currencies as well as gold, which is not controlled by any one sovereign nation yet is perceived as a universal store of value.

As we enter the last quarter of 2025, investors are weighing uneven economic growth against resilient earnings, falling inflation against stubborn cost burdens, and U.S. fiscal imbalances against persistent demand for all but the longest-dated Treasuries. It is an environment that resists simple labels. It is neither unambiguously bullish nor bearish; rather, it calls for humility, discipline, and vigilance.

At Clear Harbor, our mission remains unchanged: to help clients navigate transitions in both markets and their own financial lives with clarity and confidence. With a deep bench of professionals and a toolbox of investment strategies diversified across equities, fixed income, alternatives, and commodities, we believe investors can position for durable success—even through periods of conflicting data or dramatic change.

As always, we thank you for your continued trust. We welcome your questions as we navigate this period of uncertainty and opportunity together.

Best,

A handwritten signature in dark ink, appearing to read "Aaron Kennon", with a long horizontal flourish extending to the right.

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ⁱⁱ Year-to-date data is as of the end of day closing price on September 29, 2025.