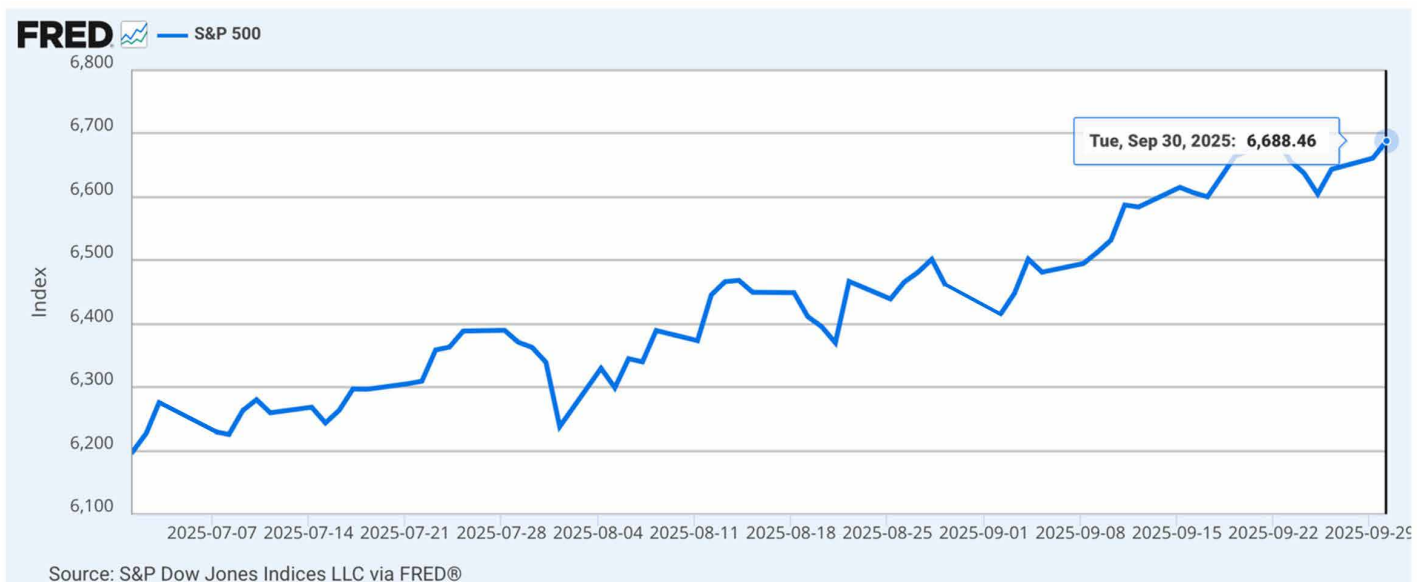




QUARTER MARKET REVIEW

- ◆ Market Snapshot
- ◆ Price to Earnings Update
- ◆ Equity Market Concentrations
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S&P 500 CHART FOR 3RD QUARTER 2025



MARKET SNAPSHOT

The third quarter of 2025 extended the market's rebound as growth remained steady and the Federal Reserve shifted toward a more supportive policy stance. In September, the Fed announced its first rate cut of the year, lowering the federal funds rate by 25 basis points to a range of 4.00% to 4.25%, and indicated that two more cuts are likely before year end. Headline inflation (CPI) ended the quarter at 2.9%, up slightly from the prior month, while core inflation (PCI minus food and energy) held near 3.1%. Despite the small uptick, price pressure coming from goods may be temporary for the next 6-12 months as it likely reflects a one-time adjustment due to tariffs. GDP growth for the second quarter came in at a robust 3.8%, boosted by an improvement in net exports vs. imports from the first quarter. Employment has cooled somewhat with unemployment at 4.3%, showing that the labor market is continuing to soften. These factors suggest that the market is anticipating an extended soft landing and some economic cooling. One indication of this is a sharp rise in delinquency, especially with student loans debt repayment.

Overall, the quarter reflected a positive tone. Inflation progress has slowed but remains on a stable path, the Fed has begun to pivot to be more supportive, and the economy continues to show resilience heading into the final quarter of the year. While U.S. fiscal challenges, global tensions, and the potential for economic cooling remain, investors appear to be looking ahead towards the end of the year with cautious optimism.

Selected Indices	9/30/24	12/31/24	3/31/25	6/30/25	9/30/25	3Q%
S&P 500 (Large Cap)	5,762	5,881	5,611	6,209	6,688	7.71%
S&P 400 (Mid Cap)	3,124	3,120	2,919	3,102	3,263	5.19%
S&P 600 (Small Cap)	1,422	1,408	1,277	1,333	1,449	8.70%
Dow Jones Industries (Large Cap)	42,330	42,544	42,001	44,126	46,397	5.15%
Nasdaq	18,189	19,310	17,299	20,409	22,660	11.03%
MSCI/EAFE (International)	83	76	82	89	93	4.49%
Treasury Bond Rates						
5-year Treasury Note Yield (%)	3.56	4.38	3.98	3.79	3.74	-1.32%
10-year Treasury Note Yield (%)	3.78	4.57	4.25	4.21	4.15	-1.43%

The chart below indicates the performance for each major asset category for the past 5 quarters

Domestic Stocks: The S&P 500 delivered a strong gain of approximately 7.7% in the third quarter of 2025, extending its rebound from earlier-year weakness. Large-cap technology stocks continued to lead the market, supported by momentum in artificial intelligence, semiconductors, and cloud computing. The Nasdaq outperformed with an impressive 11.0% gain, while the Dow Jones Industrial Average rose 5.2% as cyclical and value-oriented sectors regained ground. Mid-cap stocks, represented by the S&P 400, advanced 5.2%, and small-caps, measured by the S&P 600, gained 8.7%, both benefiting from renewed risk appetite, lower rates and improving breadth across the domestic equity market.

International Markets: International markets posted modest gains with the MSCI EAFE Index up 4.5%. A slightly weaker dollar and some improvement in manufacturing activity provided support, but growth in Europe and Japan have been mixed. Earnings growth abroad trails the U.S., and limited exposure to technology sectors are holding back results. The U.S. dollar ended the quarter trading near 1.17 against the euro.

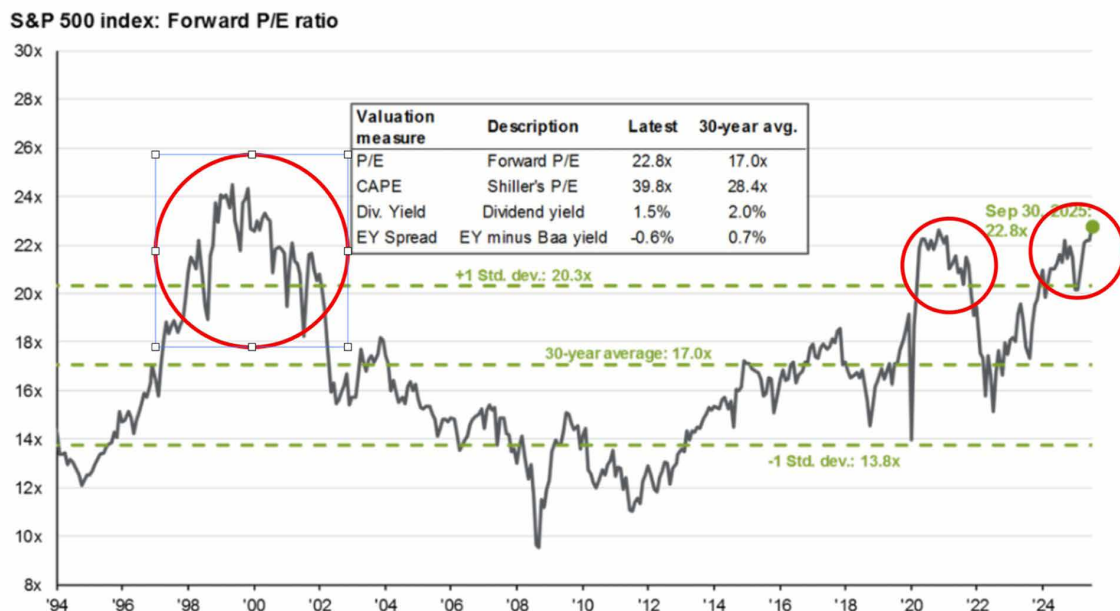
Treasury Bond Yields: Treasury yields drifted slightly lower during the quarter as markets priced in growing odds of monetary easing. The 5-year Treasury note ended the quarter at 3.74%, down from 3.79% in June, and the 10-year yield closed at 4.15%, down from 4.21%. The decline in yields reflected greater confidence that the Federal Reserve may have additional rate cuts in the final quarter of 2025. However, the continued outsized U.S. budget deficits can create supply/demand challenges for Treasury auctions that make it difficult to predict interest rate outcomes.

Federal Reserve Actions: The Federal Reserve cut the federal funds rate for the first time this year in September to a target rate of 4.0 to 4.25%. Policymakers suggested a strong possibility of two more rate cuts coming in the 4th quarter of 2025. The Fed continued its pace of balance sheet runoff, continuing the policy since April to sell off \$5 billion in Treasuries and \$35 billion in agency bonds (mainly mortgage-backed securities). Recent statements have indicated the Fed may be getting close to the end of its quantitative tightening (QT) cycle that began after the pandemic.

PRICE TO EARNINGS UPDATE

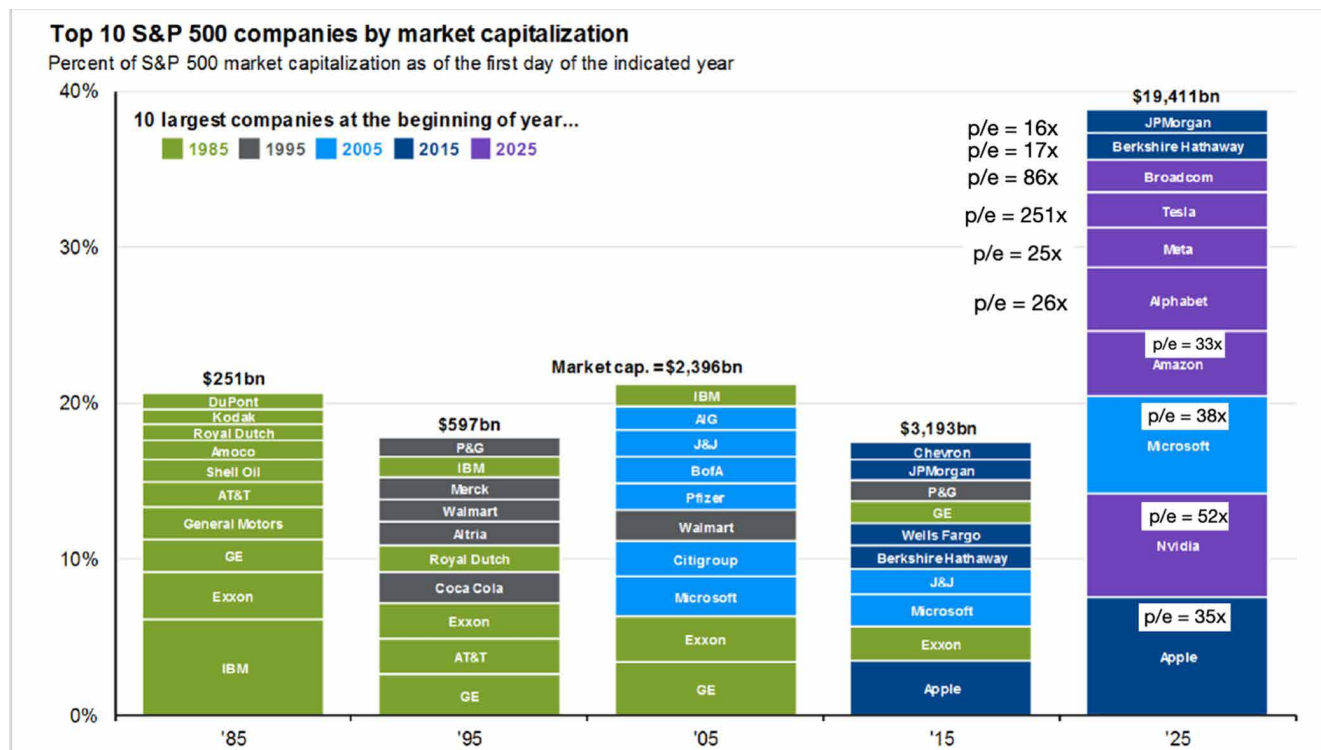
As of September 30, 2025, the S&P 500's forward P/E ratio continues to stand at 22.8x, well above the 30-year average of 17.0x and above the plus one standard deviation mark of 20.3x. As mentioned in previous reports, this pricing level has been observed three times in the past 30 years including the 1999-2001 period ("dot com") as well as 2020-2022 period. Both of those prior periods were followed with significant market pullbacks that reverted to the 30-year average or below. However, in the current bull market, growth in earnings per share has continued to propel earnings year-to-date in 2025 as year over year earnings growth is estimated at 8% according to FactSet. Top line revenue growth is expected to be 6.3%, which would be the twentieth straight quarter of growth. In the most recent quarter, 112 S&P 500 companies issued Q3 guidance, with 56 guiding up and 56 guiding down.

The dividend yield from the S&P 500 is currently 1.5%, which is lower than the 30-year average of 2.0%. This suggests that prices are relatively high, with a heavier concentration of growth-oriented companies that do not typically favor issuing dividends. As indicated below, the CAPE valuation, otherwise known as the Shiller's P/E ratio has a valuation of 39.8x vs the 30-year average of 28.4x. This valuation takes the price of the index divided by the average of the past 10 years of earnings indexed for inflation. This calculation is designed to take some of the volatility out of earnings to show a longer-term trend. Currently this valuation is much higher than the average, most likely reflecting how the largest players in the S&P 500 have had dramatic increases to their earnings over the last 10 years.



Source: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management

EQUITY MARKET CONCENTRATIONS



The above chart highlights how quickly index leadership changes. Only Microsoft remains from the 2005 top ten, and only Apple, Microsoft, and JPMorgan appear on both the 2015 and 2025 lists. The S&P 500 is now led by technology enabled platforms tied to mobile, cloud, semiconductors, and artificial intelligence. That concentration has powered returns, but it also concentrates risk in a narrow set of earnings drivers and policy variables such as regulation and interest rates. Valuations have expanded dramatically in this 10-year cycle. Both NVIDIA and Apple are each worth more than the entire top ten of a decade ago. The current top ten represents almost 40% of the index with a combined value near \$19.3 trillion versus about \$3.1 trillion in 2015.

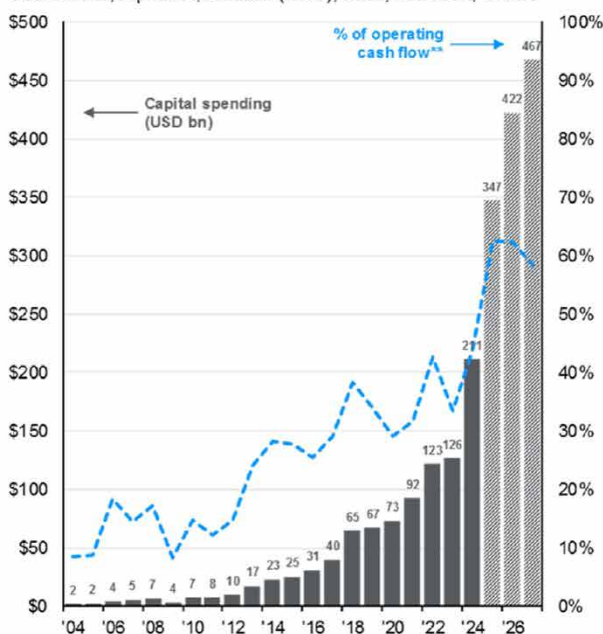
Scale came from the global reach of mobile devices, the shift to cloud delivery, network effects, and recurring revenue models, all accelerated by advances in computing and now artificial intelligence. The P/E ratios shown range widely from about 16x for JPMorgan to more than 250x for Tesla, and with the forward 12-month P/E for the index near 22.8x, future returns increasingly depend on continued delivery from these leaders. The key questions are what the top ten will look like in 2035 and how much turnover lies ahead. Uncertainty around inflation, interest rates, and valuation levels remains, though a lighter regulatory backdrop and a more accommodative Federal Reserve stance would be supportive. Diversification remains a powerful way to balance what we know today with what we cannot yet know about how these trends will unfold.



IMPACT OF ARTIFICIAL INTELLIGENCE

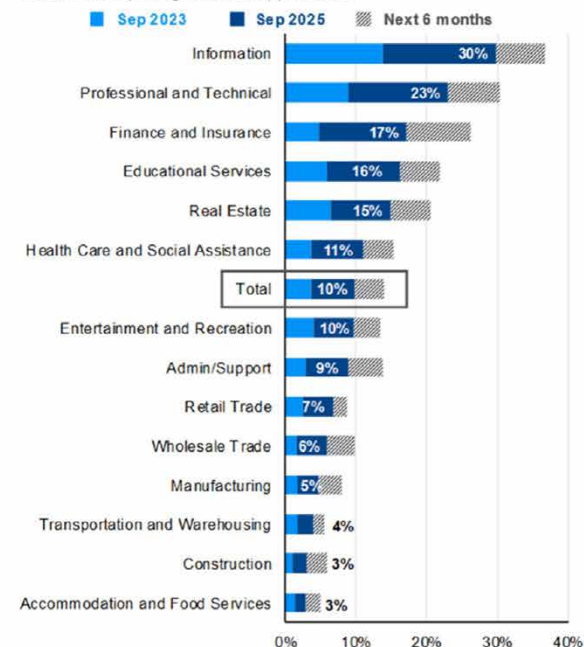
Capex from the major AI hyperscalers*

USD billions; Alphabet, Amazon (AWS), Meta, Microsoft, Oracle



Businesses using AI to produce goods and services

% of all firms reporting use of AI applications



Source: JPM; (Left) BLS, NBER; (Right) Census Business Trends and Outlook Survey

The chart on the left shows AI has entered a full-scale capital cycle. The major cloud and platform companies Amazon, Alphabet, Meta, Microsoft, and Oracle are lifting capex from about \$200B in 2024 toward roughly \$350B in 2025 and more than \$400B in 2026, which is about 60% of their operating cash flow. That commitment supports multiyear demand for semiconductors, memory, networking, data center construction, and power, and it helps explain the rise in valuation for NVIDIA given its commanding share of specialized AI chips. It also creates pressure on power, land, and grid capacity that can produce bottlenecks and cost spikes. Federal incentives such as the CHIPS and Science Act add support for this rapid buildout.

The chart on the right shows adoption in the broader economy is still early. About 10% of firms report using AI today, with the highest use in information at 30%, professional and technical services at 23%, and finance and insurance at 17%. Most sectors expect expansion over the next 6 months. The central question is whether this surge in spending will translate into the revenue and earnings needed to sustain current and future valuations. The answer will depend on how quickly enterprises move from pilots to production, how utilization of new capacity ramps, and how unit costs and pricing evolve over time.

TARIFFS AND INFLATION

One of the major themes of 2025 is the restructuring of U.S. trade policy and the impact of new international tariffs on imported goods. With several months of data since the April announcements, we can see the flow of tariff revenue more clearly. As of August, the effective total tariff rate was 11.3% for the month, which generated about \$30 billion in tariff revenue. At that pace, the annualized run rate would be roughly \$360 billion to the U.S. Treasury. A byproduct of this

initiative is to reset trade relations and raise additional revenue to help narrow a budget deficit that has been elevated in recent years.

According to the Congressional Budget Office (CBO), the new tariffs are expected to add about \$250 to \$275 billion in revenue annually, with a projected federal deficit near \$1.8 trillion in 2025. This year reflects only a partial period of full tariff implementation since the federal fiscal year ends in September, so the effect on the deficit is expected to be more pronounced in the next fiscal year as the policy runs for a full twelve months.

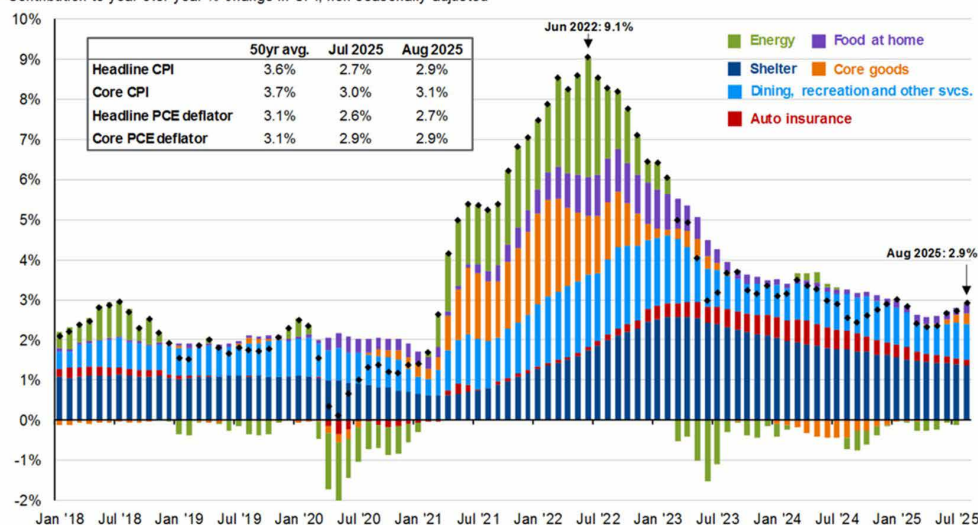
2025	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	YTD total
Tariff revenue (bn)	\$7	\$7	\$8	\$16	\$22	\$27	\$28	\$30	\$144
Imports (bn)	\$317	\$288	\$343	\$276	\$276	\$266	\$292	\$262	\$2,320
Effective tariff rate	2.3%	2.5%	2.4%	5.7%	8.0%	10.0%	9.5%	11.3%	6.2%

Source: U.S. Census Bureau, U.S. Department of Treasury, U.S. International Trade Commission

Factoring in tariffs, what impact will that have on inflation? We have already seen some limited impact over those related months, especially showing up as a rise in the cost of core goods. Thankfully, this impact has been muted. While forecasting inflation is always problematic, it has been suggested that the impact from tariffs should be observed as a “one-time adjustment”, since once it is implemented, it is set at that relative base level. If one concedes that is the case, then it could be effectively backed out of the current CPI numbers by policymakers. In other words, if you discount the tariff impact for this year the actual inflation reading might be more like 2.5-2.7% rather than 2.9%. These complicated and evolving factors have made it challenging for the Federal Reserve to make clear policy decisions such as when to end quantitative tightening (QT) and lower the federal funds. Recently, the softening of the labor market (rising unemployment) and the prospect of the tariff inflation impact being observed as a one-time hit has led them to begin to pivot as of their last meeting in September.

Contributors to headline CPI inflation

Contribution to year-over-year % change in CPI, non-seasonally adjusted



Source: Source: BLS, FactSet, JPM

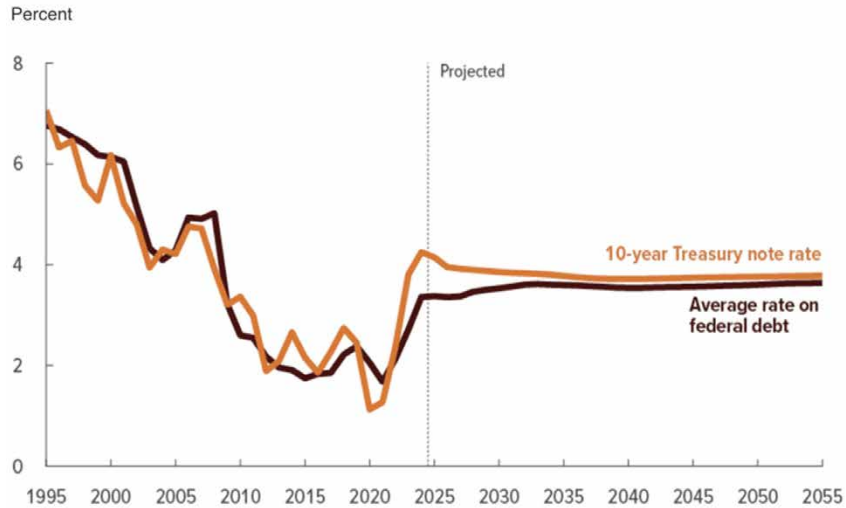
The good news is that the major drivers of inflation such as housing and energy have cooled over the past few years. The graph to the left indicates that inflation has certainly moderated with limited impact on core goods to inflation. This impact, while notable may be observed as temporary as some policymakers indicate.

THE OUTLOOK FOR BONDS

The CBO has also indicated that their projection for longer term 10-year treasury rates is expected to hover around 4% for the foreseeable future. They argue that this is because of the overhang of the U.S. Debt which is reported to be around \$37 trillion and growing. They also argue that the average rate of Treasury debt will be only slightly less than the 10-year rate, indicating that the current debt servicing will continue to be remain elevated with a relatively flat interest rate curve.

Average Interest Rates on Federal Debt and on 10-Year Treasury Notes

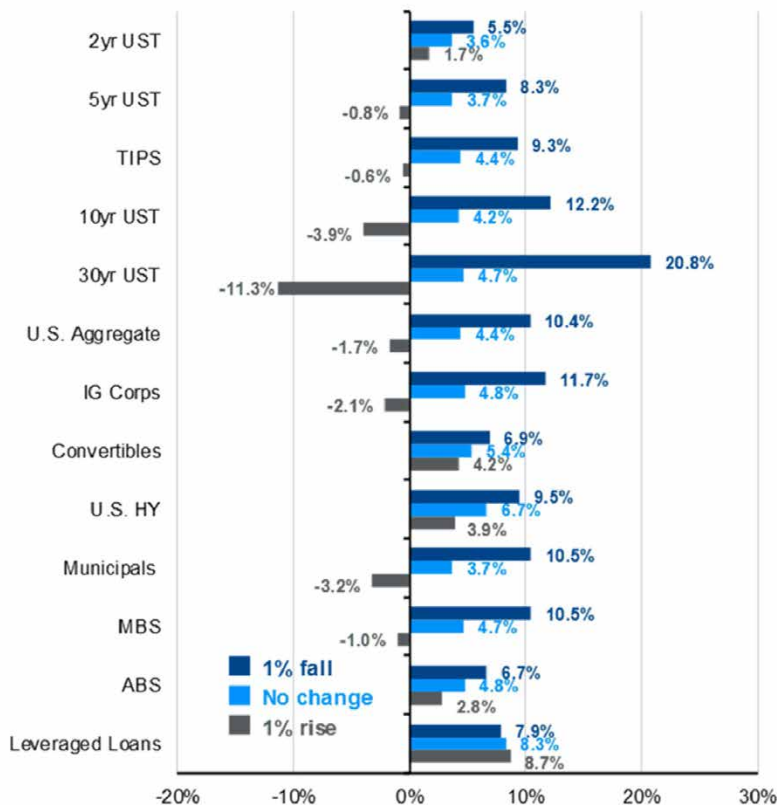
In CBO's projections, the interest rate on 10-year Treasury notes and the average rate on federal debt held by the public through 2025 are similar to what they were, on average, over the past 30 years. Interest rate projections reflect upward pressure from growing federal debt and downward pressure from slower growth of the labor force.



Source: CBO.gov

Fixed income returns in different interest rate scenarios

Total return, assumes a parallel shift in the yield curve



Source: Bloomberg, FactSet, Federal Reserve Bank of Cleveland, Standard & Poor's, U.S. Treasury, JPM.

Given the expensive valuations as noted in equities and the risks of revenues from overweighted AI related spending, bonds can offer attractive alternatives given current conditions to a portfolio. As noted in the graph to the left, shorter to intermediate duration treasury bonds are slated to produce reasonable returns even with a 1% rise in interest rates. In fact, with a 1% fall in rates, bonds are expected to produce near equity style returns in most categories. Longer term bonds are more exposed to interest rate risk, as indicated by the 10-year and 30-year Treasury assumptions. Of course, bonds carry an assortment of risks that are important to understand including credit, liquidity, and interest rate risk. A portfolio should be carefully constructed given each client's profile for risk and reward.

SUMMARY

The third quarter of 2025 delivered broad equity gains as inflation progress remained on a stable path, and the Fed cut rates by 0.25% in September to 4.00% to 4.25%. Market leadership continued to be concentrated in large cap technology and AI related platforms, while earnings expectations improved with consensus analyst estimates calling for S&P 500 EPS growth of 8.0% and revenue growth of 6.3% for 2025. Equity valuations moved higher with the forward 12-month P/E ratio near 22.8x, which raises the bar for future returns to materialize to justify the current pricing. We discussed how the continued growth of the large tech names has also fueled a sort of “AI arms race” in which these companies vie for future dominance and control of various platforms and revenue streams. International markets posted modest gains alongside a softer dollar, and Treasury yields drifted lower with the 10-year near 4.15%. Tariff policy appears to be more quantifiable with several months of data available, however policy negotiations remain fluid.

Although the market has reached new highs in 2025 and showing resiliency, signs of economic weakness are also appearing with a softening labor market, slower wage growth and higher delinquencies on credit. We discussed how bonds may provide a durable backdrop to equity volatility with modest upside should rates continue to decline. At Chancellor Wealth Management we remain committed to personalized planning and disciplined investment management, and we welcome the opportunity to support your goals.

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