TERRA NOVA
ASSET MANAGEMENT

September 2025
Market Highlights

747 Third Avenue | New York, NY 10017 | USA | tel. +1.212.355.1234 | fax +1.212.658.9904

In Brief

U.S. equities extended gains in August, with the S&P-500 up 1.9% to record highs near 6,500. Strength came from large-cap Information Technology and AI, while market breadth broadened. Lower Treasury yields, easing inflation, and solid earnings created a constructive backdrop. Valuations remain stretched (CAPE ~38), and concerns of an AI-driven bubble persist. September poses the usual seasonal risk, historically the weakest month, but the index's technical strength above its 200-day moving average offers resilience. Key catalysts ahead include jobs (Sept 5), inflation (Sept 11), and the Fed's rate decision (Sept 17). Inflation trends remained contained, reinforcing expectations that the Fed may cut rates later this year. However, valuations are elevated, which is historically a caution zone, and concern is rising over a potential AI-driven bubble. July saw a rise in Treasury yields across all maturities (2-year +24 bps, 10-year +15 bps), leading the Bloomberg U.S. Treasury Bond Index to fall approximately 0.4%. Corporate bonds, however, performed strongly—investment-grade credit spreads tightened to their lowest since 1998 as risk-off flows and strong balance sheets spurred demand.

Economy

The U.S. economy remains on a solid footing. Second-quarter GDP growth was revised upward from 3.0% to 3.3%. Productivity growth is also likely to be revised higher, boosting GDP while keeping inflation contained and supporting both wages and profits. Consumer spending and services remain strong, while inflation trends lower. This strengthens expectations for a Fed rate cut later this year. The labor market is robust, though payroll gains are moderating in line with a gradual soft landing. Business investment is supported by technology and infrastructure, while housing shows early signs of stabilizing as yields ease. Overall, the economy is progressing along a disinflationary, but growth-supportive path.

Job Market

The labor market remains a central pillar of the U.S. economy. Unemployment is historically low at 4%, but hiring momentum is moderate. Job openings are trending lower, and the quit rate has normalized, indicating reduced worker confidence compared with the post-pandemic peak. Wage growth has cooled from 2022-23 highs, but remains above pre-pandemic levels, supporting consumption without reigniting inflation. Labor supply is improving through immigration and participation, helping contain wage pressures. Overall, the job market is transitioning from overheated to sustainable a shift the Fed views as consistent with a soft landing.

Monetary Policy

Monetary policy remains a key driver for markets as the Federal Reserve approaches its September 17 meeting. With inflation trending lower and the labor market cooling down, markets are increasingly pricing the first rate this month. The Fed funds rate remains restrictive, but has slowed inflation without stalling growth, supporting a soft landing. Treasury yields eased in August, with the 10-year yield falling from 4.8% to 4.3%, reflecting declining inflation expectations and confidence in a more accommodative stance. Fed communication emphasizes a data-dependent approach, balancing the risk of cutting too soon against over-tightening. If disinflation continues, the Fed is likely to pivot toward easing, supporting financial conditions, equities, housing, and small-business credit. The transition from restrictive to neutral policy could provide an additional tailwind for equities, while also reducing stress in rate-sensitive areas such as housing and small-business credit.

USD Dollar Outlook

While markets expect a softer dollar as the Fed moves toward easing, several factors could still strengthen it: a more hawkish Fed, a global risk-off shock, or weaker growth abroad would all renew safe-haven flows. The dollar could rally if the U.S. economy proves more resilient or if uncertainty rises. In Europe, fiscal fragility and political instability in the U.K. and

France weighs on bond market confidence. Trump's tariffs and challenges to Fed independence have added stress to world economies, amplifying risks abroad.

Thoughts -Tariffs & Trade

Given the legal trajectory with two lower courts' ruling against tariffs under IEEPA and growing judicial resistance to unchecked executive authority, it appears more likely than not (above 50%) that the Supreme Court will ultimately strike them down. However, the outcome remains uncertain, as fallback options and Court dynamics could shift the decision unexpectedly. A ruling could come as early as late 2025. If tariffs are removed, the adjustment could be abrupt, impacting inflation, trade, and sentiment. Export-driven economies like China, Germany, and South Korea would benefit most, while emerging markets may see mixed effects. Overall trade volumes would likely increase, producing disinflationary effects and giving central banks more flexibility. Over time, this could encourage a modest rebound in globalization.

This would mark a significant shift in global trade dynamics. Export-oriented economies such as China, Germany, and South Korea would benefit most, as reduced U.S. import costs would stimulate demand for manufactured goods. Emerging markets could experience mixed effects: supply chains that had shifted to countries like Mexico and Vietnam may partially revert, yet overall trade volumes would likely increase, supporting long-term growth. The ruling would also have disinflationary effects, as lower import prices fed into global markets. This would give central banks in Europe, the U.K., and emerging economies greater flexibility to ease policy, reinforcing growth momentum. Over time, such a development could encourage a modest rebound in globalization, even if geopolitical tensions still limit a full return to pre-2018 norms.

Corporate Earnings

Earnings season delivered another quarter of outsized strength. Roughly 81% of S&P 500 companies exceeded EPS and revenue expectations, well above long-term norms. Blended earnings growth reached 12% year-over-year, marking the third consecutive quarter of double-digit gains, while revenues rose about 6.4%, the strongest in nearly three years. The Magnificent Seven led the charge with 26.6% growth, and nearly 60% of companies raised guidance—a bullish sign amid ongoing tariff pressures. Tech, financials, and communication services were engines of growth; energy remains trailing.

Stock Market Outlook

Despite September's reputation as the weakest month, 2025 begins with a stronger setup. The S&P 500 enters the month at record highs and well above its 200-day moving average, a technical backdrop that historically supports gains. Lower yields, easing inflation, and resilient earnings provide a supportive foundation, while sector strength is broadening beyond mega-cap tech into healthcare, financials, and defense. With the Fed poised to signal easing, equities may defy seasonal weakness and continue advancing.

The recent Fed signal for potential rate cuts, combined with elevated income levels, supports the case for long-duration bonds to deliver meaningful total returns. However, we watch for evolving fiscal pressures, the yield curve's trajectory, and political risk to influence bond demand and yield trends.

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