WestStar
Wealth Management

WEALTH WATCH

2025 Third Quarter Review
& Fourth Quarter Outlook

Following an extended pause, the Fed resumed its rate-cutting path in September. It is expected that we may see another two cuts in 2025 and two to three more next year. The level at which the Fed ultimately stops is one they deem the "neutral real interest rate," commonly called "R-star" and denoted as "r*" in finance parlance. This evokes Shakespeare's Julius Caesar when Cassius states, "The fault, dear Brutus, is not in our stars, but in ourselves."

The Fault in Our Stars

Cassius conveys to Brutus that the future is determined not by mere fate but by actions. Such will be the case for the continued strength of the economy and markets—impacted not by ethereal forces but by governmental and central bank policy.

As it relates to the latter, the Fed studies other "stars" which influence its interest rate policy. These include factors such as the unemployment rate ("U-star", or "u*") and price changes via inflation ("P-star," or p*). Perhaps it was these variables that Chair Jerome Powell had in mind when he stated, "As is often the case, (The Fed) is navigating the stars under cloudy skies."

In this edition of the Wealth Watch we will also examine the "stars" to assess the current state of the economy, potential Fed and government policy, and expectations for the fourth quarter of 2025 and beyond.

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What You Need To Know:

- All major asset classes were positive in the third quarter
- International and Gold were the best performing categories
- The Fed resumed cutting interest rates following a 9-month hiatus
- Stocks and bonds tend to rally following an easing cycle restart after a prolonged pause
- Government shutdown typically has minimal impact on stocks and economic growth, though longer lapses have greater volatility
- Current conditions remain favorable for International investments
- Continue to adhere to your long-term investment strategy to best achieve your objectives

Asset Class Index Performance* Year-To-Date September 30, 2025

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International Emerging Market Stocks
27.53%

International Developed Market Stocks
25.14%

US Large Cap Stocks
14.83%

Real Estate (REITs)
11.26%

US Small Cap Stocks
10.39%

Commodities
9.38%

International Bonds
9.36%

High Yield Bonds
7.22%

US Investment-Grade Bonds
6.13%

Alternative Investments
5.68%

Money Market (Cash)
3.20%

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Shooting Stars: Continued Market Strength

Investors looked past tariffs, rising unemployment, rising inflation, extended stock valuations, squeezing profit margins, and dubious Fed independence in the third quarter. All major asset classes were positive—the first such occurrence in over six years. Indeed, the S&P 500 Index had its best September since 2010 despite it typically being the weakest month for the market historically. The market has rebounded handily from the steep decline lows of April and, as shown on the table at right, is only the 10th time since 1929 that a drop of at least 10% was immediately followed by a rally of at least 10% through Q3. Of greatest interest in this analysis is that in every past instance, the market continued to climb in the fourth quarter by an average of 7.5%. Based solely on this historical perspective, the final three months of 2025 may also be poised to mirror the positive momentum of the first nine. That said, while we always caution that past performance is no indication of future results, we also note that history may not repeat but it often does rhyme. Accordingly, if we harken back to the "R-star" topic noted earlier, we can examine the typical trajectory given a major influence on future market performance—the actions of the Fed.

2025-Like Rebounds Typically Bode Well for Q4
S&P 500: 10%+ Decline & 10%+ Rebound Through 9/30

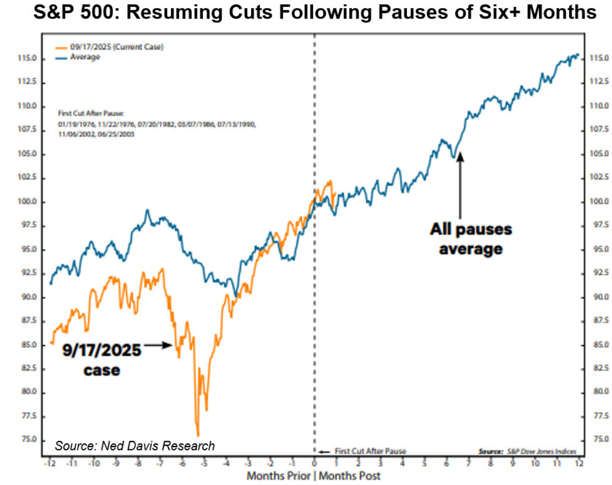
Year	Max Decline Through 9/30	2025 Through 9/30 (%)	Q4 (%)
1933	-24.7	42.7	2.8
1935	-15.9	22.0	15.9
1936	-12.8	19.2	7.3
1938	-28.9	16.0	7.9
1950	-14.0	16.1	4.9
1975	-14.1	22.3	7.5
1980	-17.1	16.2	8.2
2003	-14.1	13.2	11.6
2009	-27.6	17.0	5.5
2025	-18.9	13.7	??
Mean	-18.8	20.5	8.0
Median	-15.9	17.0	7.5

Source: Ned Davis Research

Written in the Stars: Fed Easing Cycle Resumes

The Fed has a dual mandate: maximum employment (u*) and price stability/inflation (p*). It is how they define these "stars" and how each compares to current actual economic readings that determine The Fed's actions in pursuit of the neutral real interest rate (r*). The Fed will typically cut rates if unemployment is above their long-term 4.2% forecast and hike rates if inflation is above their 2% target. Given that the current unemployment rate of 4.3% is only negligibly above its forecast and current inflation at 2.9% is markedly above its target, one might question why they resumed cutting rates in September. The answer may relate in part to politics, as the Trump Administration has aggressively asserted itself into Fed matters. Given that the Fed has resumed its easing cycle after a nine-month pause, how might markets react? Going back 50 years, the chart at right shows the behavior of the stock market around the first Fed rate cut following a pause of at least six months during an easing cycle. We find that historically the market tends to rally, averaging +1% over the ensuing three months, +6% over six months, and +15.5% over 12 months. This would be another indicator that stocks may still have additional upside potential in the fourth quarter of 2025. The same holds true for bonds in this scenario, as the 10-year Treasury has also rallied on average over these same periods. Yet might the government shutdown have an impact on what might otherwise be an optimistic outlook?

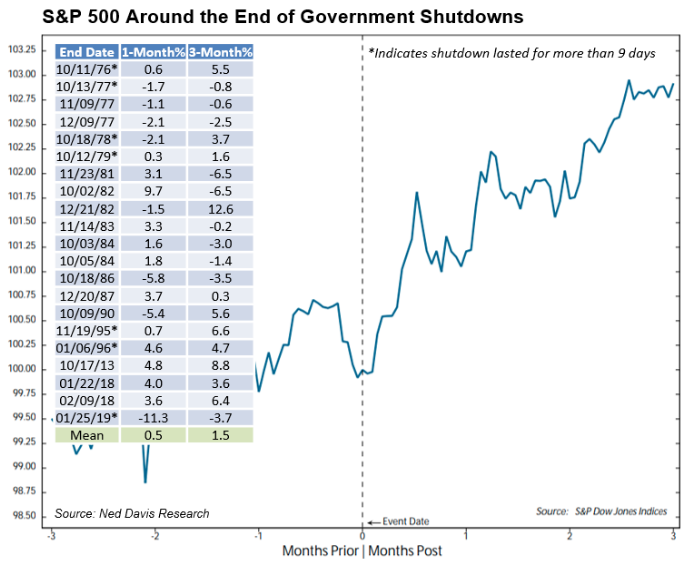
S&P 500: Resuming Cuts Following Pauses of Six+ Months



*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Developed: MSCI EAFE Index; Int'l Emerging: MSCI Emerging Markets Index; US Inv-Grade Bonds: Bloomberg Aggregate Index; Int'l Bonds: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodities: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

Star-Crossed: Government Shutdown

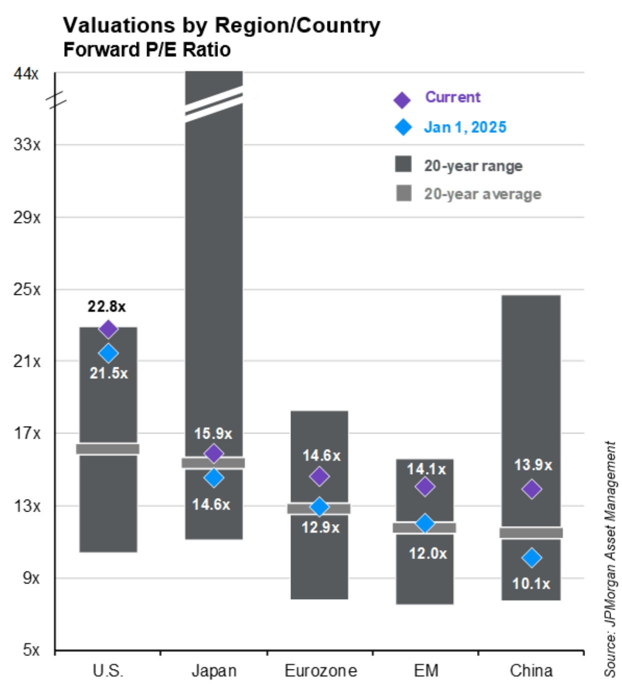
Over the past 50 years there have been 21 government shutdowns. These shutdowns have lasted between 1 to 35 days, averaging 9 days in duration. Examining the chart at right shows that the market typically dips slightly but rebounds swiftly, rising +0.5% over the month following the shutdown and +1.5% over three months. Recognizing that the current instance has lasted beyond the 9-day average, however, we can parse the data to determine the impact of a prolonged shutdown. Amid these lengthier occasions the market does tend to be a bit more volatile but overall relatively subdued, with a -0.7% in the month following and +2.8% over three months. Economically, the drag on GDP growth is approximately 0.1% - 0.2% for every week the shutdown lasts. This also has historically tended to rebound quickly upon the government reopening. This time could be different, however, as the Administration has signaled that, unlike past instances, furloughed and essential workers may not receive missed backpay which could weigh on growth going forward. Meanwhile, the longer the shutdown persists, the greater the uncertainty and the delay in economic data distribution could adversely impact both policy makers and investors alike.



End Date	1-Month%	3-Month%
10/11/76*	0.6	5.5
10/13/77*	-1.7	-0.8
11/09/77	-1.1	-0.6
12/09/77	-2.1	-2.5
10/18/78*	-2.1	3.7
10/12/79*	0.3	1.6
11/23/81	3.1	-6.5
10/02/82	9.7	-6.5
12/21/82	-1.5	12.6
11/14/83	3.3	-0.2
10/03/84	1.6	-3.0
10/05/84	1.8	-1.4
10/18/86	-5.8	-3.5
12/20/87	3.7	0.3
10/09/90	-5.4	5.6
11/19/95*	0.7	6.6
01/06/96*	4.6	4.7
10/17/13	4.8	8.8
01/22/18	4.0	3.6
02/09/18	3.6	6.4
01/25/19*	-11.3	-3.7
Mean	0.5	1.5

Star of the Show: International Stocks

In last quarter's issue of the Wealth Watch we noted that in environments such as this, the best performing asset classes tend to be International and Gold. Indeed, as reflected in the Index Performance bar on page 2, International stocks are the top performers among the major asset classes this year and, while not shown on the chart, Gold is up nearly 50% year-to-date through September! A large portion of this stellar performance can be attributed to the weakness in the US dollar which is down -10%. Given the aforementioned factors relating to the US slowing economy, rising inflation, and Fed rate cuts, we expect the dollar may weaken further. This, coupled with the International assets being relatively inexpensive, may also lead to continued outperformance in the asset class. The chart at right shows how that US stocks are near the top of their 20-year average "expensiveness" and well above the average of that metric. Meanwhile, International stocks are much more reasonably priced despite this year's rally. International stocks remain attractive as we approach 2026.



Reach for the Stars: Investment Strategy for Q4 & Beyond

The markets have continued to post impressive results through the first nine months of 2025 and we may see such strength continue in the final months of the year. While the economy is showing signs of slowing, at present there does not seem to be any indication of recession in the near term and our tactical asset allocation positioning remains neutral. We will continually monitor developments as they arise and, for actively-managed clients, will proactively reposition as warranted. That said, there are a number of wild cards that could have an impact as we enter 2026. Akin to Fed Chair Powell's "navigating the stars under cloudy skies" comment, we must also rely upon our long-term strategic investment strategy to be our guiding star despite any clouds that may form on the horizon. For as Leonardo da Vinci advised, "Fix your course on a star and you can navigate through any storm."

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