



From The CIO's Desk

Market Commentary | Q4 2025

Quarterly Market Perspective

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The direction of the market during the third quarter was highly influenced by two storylines: a weakening labor market and prodigious acceleration in Artificial Intelligence (AI)- driven capital spending. Collectively, these trends resulted in favorable returns, with stocks gaining 7%¹, while bonds added 2%².

The labor market notably softened with a July employment report depicting a surprising slowdown in payroll growth, along with revisions to data from May and June that extrapolated July's data into a broader trend. As we break down the data, the slowdown in employment is more pronounced among government payrolls, along with professional and business services. Industrial segments of the economy, such as manufacturing, construction, and mining, have also faced some modest contraction. While the magnitude of the slowdown was surprising, the pockets of observed weakness are consistent with the direction of the Trump Administration policies, given a focus on managing the size of the government employee base and the ramifications of tariff policies on near-term industrial production. As we look forward, we've started to see more stable readings around initial jobless claims and aren't seeing widespread company actions to reduce labor. We remain optimistic that what transpired in the third quarter was a reset in the baseline of labor activity.

Regarding AI-related capital expenditures, companies such as Meta and Alphabet (Google) increased their spending plans for AI infrastructure and data center buildouts. An added surprise from OpenAI's September announcement of a \$300 billion planned multi-year

data center buildout with Oracle. As we've talked to companies across public and private markets, the pipeline of opportunities around data center construction and the infrastructure needed to power them remains a heavy area of investment. Collectively, what we saw in the third quarter indicated that AI-related investment accelerated to a more formidable level, with increased investment spending coming from a variety of economic participants.

While we recognize the growth and productivity opportunities that AI will enable, we find there remains considerable ambiguity around the number of substantive large language models and Generative AI tools that will ultimately become useful, as well as which providers will arise as economic beneficiaries. This progression is, in some regards, analogous to the evolution of internet search engines three decades ago. The stakes are high for AI model providers to generate the economic returns necessary to justify the \$500 billion of projected AI capital investment by major tech players in 2025, a level that is likely to grow further in 2026. Given this perspective, we are electing to position portfolios to have broad exposure to potential AI leaders, while being cognizant of not being too exposed to a reliance on a single AI player being a dominant beneficiary, given that AI model development and usage remain in their infant stages.

As we consider the economic environment ahead, we must acknowledge that the current tariff policy will have an impact on curtailing the pace of economic growth. To date, tariffs have had a limited influence on growth, although many of the trade agreements that are now

in place were not finalized until some point in the third quarter. Annualized tariff revenue is estimated to be around \$350 billion, an amount that is equal to roughly 15% of total personal income tax payments. This won't be inconsequential and will either lead to higher prices (inflation), pressure profit margins if companies choose to bear the cost, or a combination of both. We believe most companies are in the early stages of determining which approach to take, and we expect any tariff-induced price adjustments to come over time, through multiple, modest price increases. We expect the digestion of tariffs will go well into 2026 before the economic picture becomes clearer.

Given this perspective, our base case scenario is for a continuation of a second-half of 2025 moderation in economic activity, which likely extends into the first part of 2026. However, as we get deeper into 2026, the combination of lower interest rates out of the Federal Reserve, benefits to personal taxes from OBBBA cuts, and accelerating investment given the accelerated depreciation allowed by the OBBBA, will lead to a more stimulated economy in the spring and beyond.

As we assess the market today and look across various assets, we see few areas of dislocation. The rebound in stock and bond prices since early April lows has resulted in asset prices that today are categorically reflecting the continuation of favorable economic conditions. When we consider market sentiment, investor perspectives during the year have gone from excitement to extreme pessimism to what is now heightened optimism. While we remain optimistic in our outlook, the elevated uncertainty around the path that economic and business conditions may take leaves us conscious of the risks associated with constructing a portfolio for a specific outcome. Our approach is to incorporate additional layers of diversification where it makes sense, where returns are expected to be additive, and continually assess whether portfolios are overly exposed to a specific scenario. For example, earlier this year, we increased exposure to international equities in portfolios where appropriate. More recently, in some fixed-income portfolios, we added exposure to Treasury Inflation Protected Securities (TIPS), whose interest payments (coupons) are linked to inflation. We will continue to consider other avenues of diversification, like these, to incorporate as they make sense.

➤ CONCLUSION

The third quarter provided greater clarity around the direction of tariffs, the path of the economy, and the cadence of growth for thematic trends such as artificial intelligence. While these elements provided improved clarity around the range of prospective economic and market outcomes going forward, there remains uncertainty in the path of the economy. We expect a level of moderation in the near-term but see opportunities for improving growth as we move further into 2026. Asset prices reflect an optimistic viewpoint, driving our focus on ways to improve diversification, alongside continuing to further emphasize longer-term thematic trends that we believe will benefit investors with multi-year investment horizons.

¹ Source: As represented by the return of the S&P 500. | ² Source: As represented by the Bloomberg U.S. Aggregate index.



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