ClearPoint
ADVISORS INC

Quarterly Commentary

Third Quarter 2025

Investment Commentary

AI enthusiasm and a softer Fed stance fueled a broad market rally in Q3. The S&P 500 posted gains in all three months, finishing the quarter up 8.1%, while the NASDAQ surged 11.2%, reflecting technology's unrelenting momentum. Corporate earnings provided an additional boost, with third-quarter S&P 500 profits estimated to have grown 8.0% year over year. A key shift in Q3 was the rally's expansion beyond mega-cap leaders.

The Federal Reserve dominated headlines with multiple fits and starts. The July FOMC meeting featured two dissenters pushing back against the Fed's hawkish tilt. The quarter ended with the appointment of a notably dovish governor—just in time for a 0.25% rate cut in September. Following the Fed's first rate cut of 2025, expectations for further easing drove strong inflows into smaller, rate-sensitive companies. The Russell 2000® Index gained 12.4%, outpacing large caps and hitting its first all-time high since 2021. Sector gains were broad-based, with factor indices reflecting a clear "risk-on" tone. High volatility strategies led, and the growth style handily outperformed value.

The concentration in the "Mag 7" stocks is back in the spotlight. The "Magnificent Seven"—Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla—now command *nearly 33%* of the S&P 500's market cap, the highest level in recent years! Fueled by AI enthusiasm and relentless momentum, their dominance has pushed indexes to new highs and stirred debate over whether this rally is edging into bubble territory.

Lower Rate Opportunities

Prices of fixed income securities moved higher as interest rates fell, with the Barclays Agg (US Bond) Index rising 6.4% year-to-date.Over $7.3 trillion is currently parked in cash-equivalent investments that deliver attractive returns with zero market risk. While much of this capital represents institutional holdings or emergency savings, some outflows are likely as the Fed begins cutting rates.Lower rates should support risk assets, even as longer-term yields may rise modestly on concerns about the sustainability of US debt levels. From an investment standpoint, credit remains attractive relative to cash. We favor short-intermediate duration credit exposure across investment grade, high yield, and municipals, given tight spreads and expected volatility.

However, the impact of lower rates may be limited, especially in housing. High home prices and sticky long-term rates continue to constrain affordability, with the 30-year fixed rate mortgage at 6.3%. Although inflation has eased from its 2022 peak, tariff effects may begin to push up goods and services prices again. These pressures could build over the next 6–9 months, but the jury is still out.

Labor and Immigration

The labor market has softened more than previously expected. Hiring has slowed as policy uncertainty weighs on businesses, and tighter immigration has reduced labor supply. These shifts complicate the Fed's mandate—slower job growth supports easing, but wage pressures may limit how far the Fed can go. Adding to the shifting economic picture, the Bureau of Labor Statistics recently issued its largest preliminary revision on record, revealing that U.S. job growth was overstated by 911,000 positions in the 12 months through March 2025. This revision lowers average monthly job gains to roughly 70,000--less than half the pace initially reported. The adjustment casts a more moderate light on the strength of the labor market and gives the Federal Reserve additional data points to weigh as it considers the timing and pace of future rate cuts.

Immigration and tax policy shifts will also shape the outlook. Tighter immigration may keep upward

pressure on wages, while fiscal changes could offer some business tailwinds. The current government shutdown is expected to have a temporary but measurable impact on growth, depending on its duration.

Consumers are still spending, mainly driven by higher-income households benefiting from wealth effects in housing and financial markets. However, savings buffers have been depleted, leaving consumption more exposed if inflation accelerates or markets weaken. With supply shortages and locked-in low mortgage rates keeping residential real estate sales activity low, modest rate cuts are unlikely to change this dynamic meaningfully.

Trade Concerns

Tariffs remain a key source of uncertainty. A mix of ongoing negotiations and legal battles has created a stop-and-start trade mentality. We expect "moderate but elevated" tariffs to persist, adding to inflation pressures, especially for goods like furnishings, staples, and electronics. The full economic impact may take several quarters to appear, but many economists expect the inflation impact to be transitory.

Trade agreements with the EU and Japan were largely in line with expectations, and a 90-day extension of the China tariff pause tempered concerns. Industry-specific tariffs contained loopholes that softened their impact, while declining jobless claims offset weaker payroll data. Core inflation stayed well above 2%, but anticipated tariff effects moderated as the quarter progressed.

Business sentiment has cooled, especially among large firms facing rising costs and uncertainty from tariffs. Smaller businesses remain more upbeat, but are beginning to show signs of slower sales growth.

Artificial Intelligence Dominance

AI again remained a key driver of market sentiment. Massive government contracts and expanded spending plans by leading tech firms like NVDA ignited investor enthusiasm. Markets focused less on deal specifics and more on their scale, bidding up nearly any company tied to the AI boom. While skepticism grew in some corners, AI optimism ultimately drowned out the critics. We view this as part of a broader productivity and capital spending cycle, supported by large-cap tech earnings and investment. Concentrated revenue streams among "hyperscalers" (the large-scale cloud storage companies) create some risks, but overall demand for advanced chips and infrastructure remains robust, supporting U.S. large-cap equities.

Markets are glued to the Fed, trying to guess whether rate cuts will arrive and by how much. Historic seasonality brings multiple tailwinds; markets tend to do well in the fourth quarter, and they usually do well in the 12 months following rate cuts that happen near all-time highs. However, stubborn inflation and mixed policy signals could awaken the volatility that hibernated back in April. Market valuations are also a concern. So even with all eyes on the Fed, tariffs, and politics, there is still nothing more important than strong corporate earnings.

As always, we welcome a discussion of how these factors may influence your portfolio.

Warm Regards,

Clear Point Advisors