

Quarterly Outlook

At-A-Glance

Against the backdrop of a weakening labor market and several months of post-tariff inflation data, the Fed lowered interest rates by 0.25% in September – its first cut since December 2024. Market expectations now point to two more cuts by year-end.

After a weak first quarter, the S&P 500 is on track for its second consecutive quarter of gains.

Value stocks led the way in the first quarter, but growth stocks have reversed this trend in the following quarters.

International equities remain strong, but leadership has changed. Emerging markets have taken the lead over developed markets in year-to-date (YTD) performance.

Small-cap stocks are having another good quarter too, outpacing both domestic and international large-cap stocks as they benefit from lower rate expectations. They still trail the S&P 500 on a YTD basis due to a sharper decline earlier in the year.

Long-term bond yields fell as inflation concerns dissipated and labor markets weakened.

Bond yields move inversely to bond prices, so bonds are having a good third quarter. The aggregate bond index is up around 2.5% in Q3 heading into the last week of the quarter.

Are We Entering a Jobless Expansion?

As we enter the final quarter of 2025, the investment landscape is defined by a mix of cautious optimism and structural uncertainty. The Federal Reserve (Fed) is expected to resume rate cuts in late October and December, responding to a cooling labor market even though inflation remains above its 2% target.

While investors are hopeful about easier monetary policy, the underlying reason—slowing job growth—raises questions about the sustainability of the recovery. A “jobless expansion” remains a possibility, where economic growth continues despite weak employment trends. This scenario could be supported by corporate earnings, thanks to easing wage pressures, but it also introduces risks to consumer demand, especially among lower- and middle-income households.

Equity markets have rebounded sharply since the April lows, with valuations now elevated and earnings expectations rising. The S&P 500 trades at a valuation multiple well above its historical average, and while mega-cap tech stocks continue to lead, broader sector participation is improving. However, increased volatility and shifting sector leadership are likely as markets adjust to new macro conditions. Diversification remains critical, particularly as companies that thrived in the previous cycle may struggle to meet heightened expectations.

International equities have outperformed U.S. large-caps year-to-date, supported by rate cuts from major central banks, more attractive valuations, and a weaker dollar. Opportunities exist across both developed and emerging markets, though risks persist in China due to structural challenges and in Europe and the Middle East due to geopolitical tensions. Export-driven economies may face headwinds if global demand continues to soften, reinforcing the need for selective, fundamentals-based investing.

In fixed income, bonds are quietly having a strong year. Treasury yields have declined from over 4.5% to around 4%, aligning with long-term expectations based on real GDP growth and inflation. The aggregate bond index is up 6.5% year to date, and yields remain attractive for income-focused investors. High-yield bonds offer elevated returns but come with equity-like volatility and tight spreads, suggesting limited diversification benefits. Overall, the fourth quarter presents a potentially complex yet navigable environment, where clarity on tariffs, Fed policy, and labor trends will likely be key drivers of market direction.

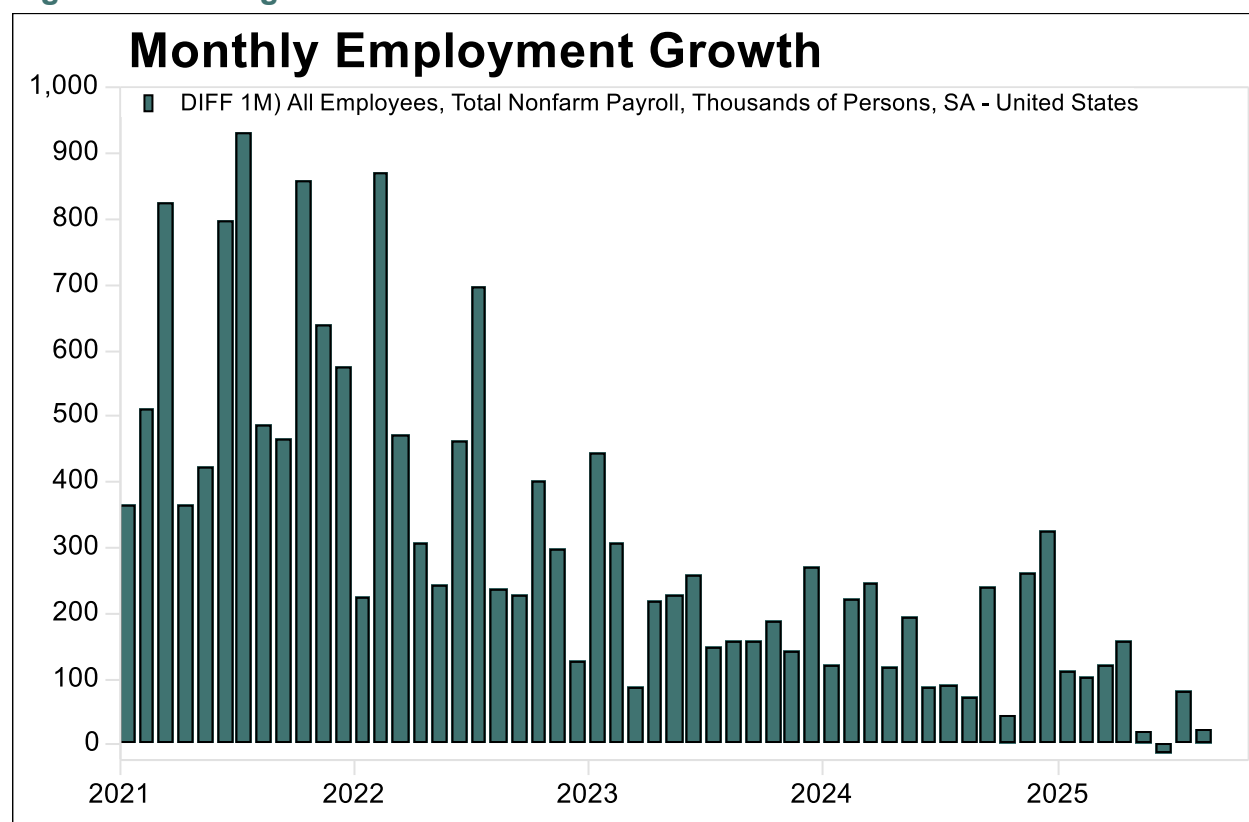
Economy

Taking Stock

With the fourth quarter underway, it's an opportune time to reflect on the year's developments and consider what lies ahead. Our three predictions for 2025 have largely already come to fruition: 1) economic growth would moderate, 2) the Federal Reserve would be hesitant to cut rates, and 3) diversification would finally be rewarded.

First-quarter GDP growth turned negative and job growth saw a sharp downward revision that carried into the second quarter. Hiring has continued to slow (**Figure 1**), while retail sales have been uneven throughout the first half of the year.

Figure 1: Slowing Job Growth



Source: Cetera Investment Management, FactSet, U.S. Bureau of Labor Statistics. Data as of 8/31/2025.

The Fed has been perhaps the biggest story of 2025, as it cut rates by 1% over the final 3 Federal Open Market Committee (FOMC) meetings last year, before pausing until this past September as the labor market continued to cool and inflation remained above the Fed's target of 2%. This did not surprise us as the Fed seemed willing to hold off on rate cuts until it got a clearer picture of how tariffs would impact inflation. While the labor market softened, it remained stable enough to allow the Fed to take a wait-and-see approach.

Finally, after two years of S&P 500 returns over 25%, which was the first time that had happened since 1998, driven largely by major tech companies, we thought this could be the year we see other sectors and asset classes broaden and show strength. Going into the fourth quarter, international stocks are still up

around double the return of the S&P 500. While value, mid-cap and small-cap stocks haven't quite kept up with the most recent growth rally, the disparity is much less than prior years.

The Final Quarter

With our three themes entering the year largely already playing out, the fourth quarter could be an inflection point. There is more clarity around tariffs and labor market conditions have softened enough that the Fed can no longer be patient. We expect the Fed to cut further in the fourth quarter, perhaps in both late October and December. While investors are optimistic about the possibility of additional rate cuts, they could be overlooking the reasons driving these cuts. After all, the Fed is cutting rates in response to a slowing job market. Could this be a jobless expansion where the job market is soft, while markets rise and economic growth remains steady? We think this goldilocks scenario of a jobless expansion could play out, but there are risks to this thesis.

The Goldilocks Scenario

At a high level, the U.S. economy appears to be on solid ground. While the first quarter was negative at -0.5%, we saw a rebound in the second quarter of +3.3% and the Atlanta Fed's third quarter GDPNow forecast is for +3.3% growth as of this writing. This is relatively consistent with London-based economic firm Capital Economics' estimate of 2.8% growth. Capital Economics estimates 2025 real GDP growth will be 1.9%, down from 2.8% in 2024, but this also fits the theme we discussed earlier about moderating economic growth. Slower growth was expected as stimulus money from the pandemic slowly dries up.

Last quarter we wrote about soft data versus hard data. The soft data, or more forward-looking data from surveys, painted a different picture than the hard data, or quantifiable reported data from government sources. Since then, the soft data appears to have stabilized, and the most forward-looking components of this soft data have rebounded. For example, new orders in both the manufacturing and service sectors rebounded sharply in August.

The biggest concern right now is around the labor market. While the unemployment rate is relatively low at 4.3%, it's the highest since 2021 and the pace of job creation has slowed significantly. The good news is that companies also aren't laying off a lot of workers either. The ratio of job openings to unemployed workers is now below parity, something we haven't seen since the pandemic. But this is also good for corporate earnings because it puts less pressure on wage growth and inflation. Slowing labor market conditions align with our broader theme of moderating economic growth.

Tariffs on Trial

One of the biggest potential disruptions to markets and the economy in the fourth quarter could be the U.S. Supreme Court's hearing regarding tariffs, which is set to take place in early November. The Court could rule as early as the end of 2025, but the decision may also extend into the new year. It is conceivable, although legal experts are mixed on the topic, that the Court could strike down some of the tariffs, especially the broader, sweeping reciprocal tariffs. If this happens, the government may have to pay refunds and stop collecting much of the tariff revenue. The economic and market impact is very difficult to predict and may be less intuitive, as there are so many variables.

For instance, removing the tariffs may cause higher bond yields, which is not good for equity markets. However, inflation could also fall, allowing the Fed to cut rates further, which is good for the stock market. Trying to quantify how all these factors play out in the real world is impossible. There will also likely be an

impact to the U.S. dollar, which could weaken as the U.S. fiscal deficit rises. These are just a few examples of the complexity surrounding predictions about tariffs.

Amid all the uncertainty, one outcome appears increasingly likely – heightened market volatility. We could see big swings in both equity prices and bond yields as investors try to assess the impact. The good news for the economy is that the uncertainty regarding the impact and legality of tariffs could be lifted. This would also help Fed policymakers and business owners make more informed decisions. As mentioned, the Fed would likely cut rates further, and business owners may be more inclined to hire more workers, expand operations and build inventories.

Summing It Up for the Economy

Economic data has been moderating, led by weakening labor market conditions. The impacts from tariffs appear to be less than many had expected at this point, and inflation is running around 3%. While this is above the Fed's 2% target, it doesn't seem to be surging higher. Looking at consumer surveys, consumers may feel inflation is high, but they may be reacting to high prices that followed earlier inflationary spikes.

The Fed has shifted its focus from inflation to the labor market, and we can expect more rate cuts as the Fed tries to pump more life into the job market. Is the Fed too late? We may find out in the coming quarter, but we don't believe so. Economic growth appears resilient, and greater clarity around tariffs could provide a more immediate boost to business confidence and a willingness to hire workers than monetary policy alone. The Supreme Court hearing on tariffs in November may cause uncertainty in the near term as investors digest the potential ramifications, both good and bad. After that initial period of volatility, we think this certainty could act as a tailwind, regardless of the court's ruling, as markets tend to respond positively to reduced uncertainty.

Equity Markets

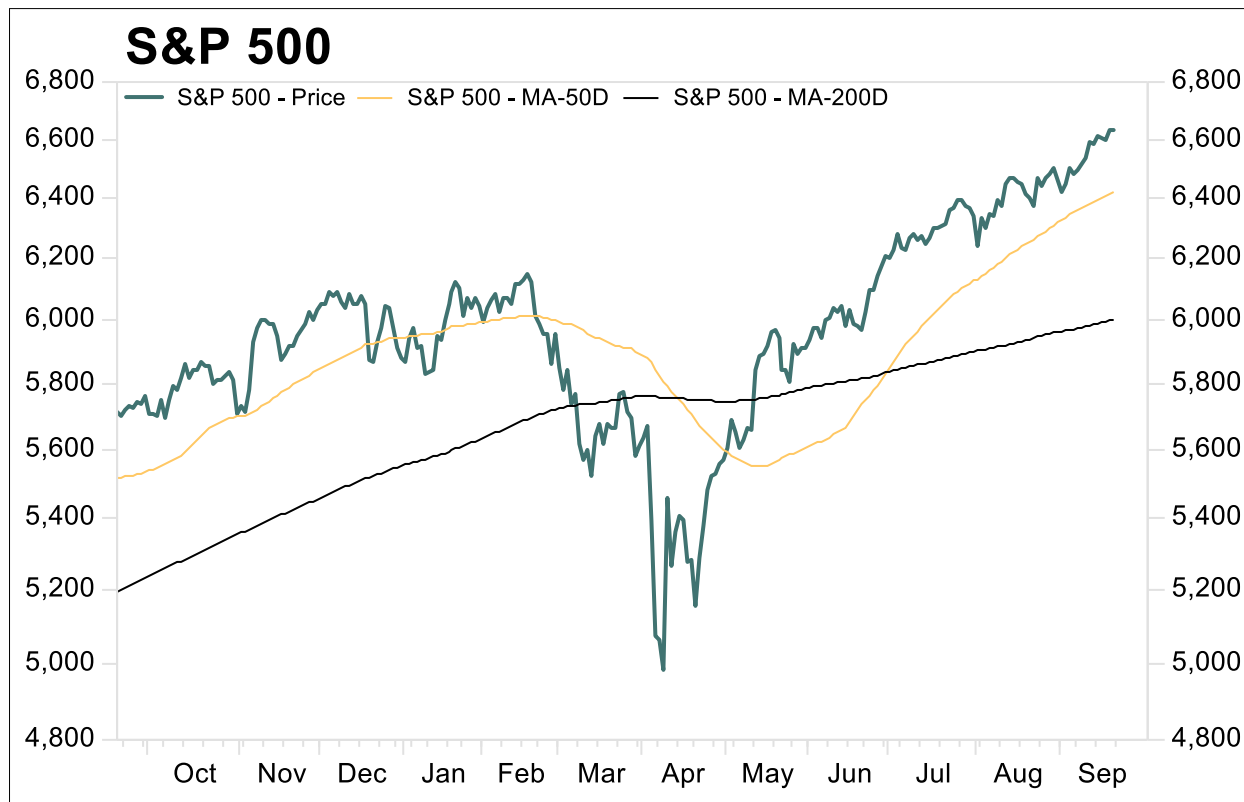
With the economy seemingly at a potential inflection point, investor uncertainty around growth and Fed policy may drive greater equity volatility until there is greater clarity. As a general rule of thumb, investors are looking six to nine months ahead, anticipating future earnings growth, interest rates, inflation and economic growth, to name a few key factors. Stock markets reaching all-time highs amid weak job growth may seem counterintuitive, but in a forward-looking context, it starts to make more sense.

Job growth has been weak over the past year, but that trend could change if tariff uncertainty eases and the Fed continues to lower rates to stimulate economic growth. While soft data has shown signs of stabilization, hard data is beginning to point to moderate growth.

Cautious Optimism Amid Elevated Expectations

While one can make a rosy outlook for equities, this bullish case is not without risks. Since stocks bottomed in early April, there has been a V-shaped market recovery (see **Figure 2**), though valuations are back at elevated levels. The S&P 500 is trading at 22.7 times forward earnings, significantly above the 20-year average of 16.4. For comparison, the forward P/E ratio is 16.3 for the S&P Mid Cap 400 and 15.5 for the S&P Small Cap 600. While earnings expectations were dampened after Liberation Day, when President Trump raised tariffs, corporate earnings came in ahead of expectations in the second quarter and corporate guidance was generally positive. With earnings optimism rising again, there will be a higher hurdle to exceed expectations. This is particularly true for the high-performing, AI-related mega-cap tech stocks.

Figure 2: V-Shaped Recovery



Source: Cetera Investment Management, FactSet, S&P Global. Log scale used. Data as of 9/18/2025

It is also possible the Fed was late to resume rate cuts, and the labor market will continue to weaken. The U.S. is a consumer-driven economy, and this would not be welcoming news for investors. Additionally, businesses are reporting that lower-income and middle-income customers are pulling back on spending relative to higher-income customers as they are struggling to keep up with high prices. Auto delinquencies for subprime borrowers have reached their highest level since 2009. The unemployment rate for both young people and those with less educational attainment is ticking up – such as among 20–24-year-olds and those without high school degrees (over the age of 25). This divergence underscores the importance of looking beyond the headline unemployment figures. While not yet flashing red, these developments warrant close monitoring as they could influence consumer demand and corporate earnings in early 2026.

These developments and potential inflection points, combined with increased volatility, could cause a divergence in sector leadership. Companies that did well in the old regime may not do as well in this new environment, which highlights the importance of diversification. Stocks that performed well in the recent past may start to underperform if they fail to meet increasingly aggressive earnings expectations. We publish a monthly [Sector Insights](#) report with additional sector-level details about both fundamentals and technicals.

Part of being diversified is investing internationally. Both international developed markets and emerging markets have done significantly better than U.S. large-cap stocks this year. Other major central banks are also cutting rates, valuations are more attractive abroad and a weaker dollar benefits international company returns. Within international markets, China has become a challenge, as it suffers from structural issues and weak consumer confidence. Geopolitical tensions also weigh on Europe and the Middle East. If the

world economy continues to weaken, it may create a drag on export-driven economies as demand softens. There are opportunities internationally, but being diversified and investing based on fundamentals may be more important.

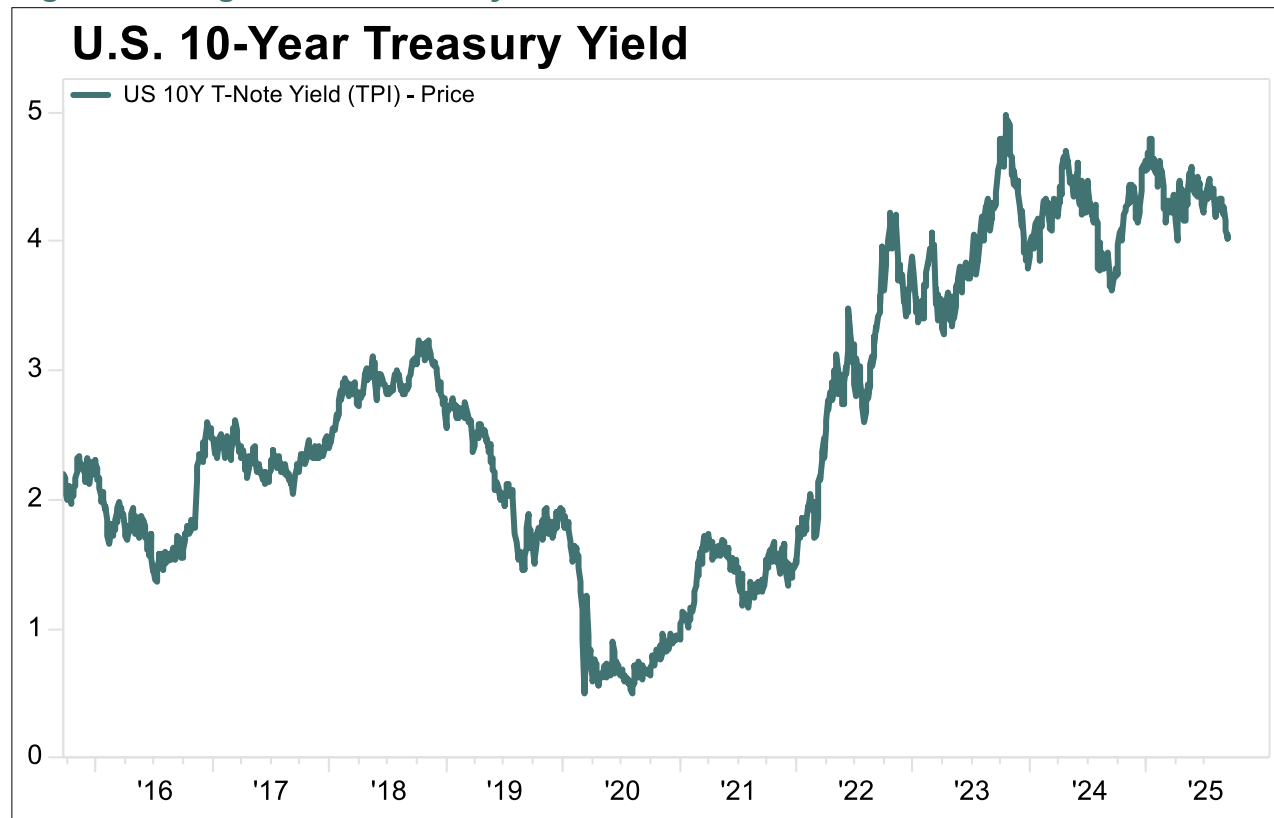
Fixed Income

While bonds are being overshadowed by equities, they are quietly having a good year. The aggregate bond index is up 6.5% year-to-date as of late September. As seen in **Figure 3**, 10-year Treasury yields started 2025 at over 4.5% before easing to around 4%, adding price appreciation to decent returns investors are already receiving from bond yields. Predicting the direction of bond yields is very difficult. If tariffs are reversed by the courts, it could put upward pressure on yields, as fiscal deficits could climb. Meanwhile, technological innovations and an aging population should continue to pressure bond yields lower, as they did prior to the pandemic. Governments also have an incentive to keep yields low to finance their borrowing costs. As a rule of thumb, long-term bond yields should equal 12-month real GDP growth plus inflation, and using the Fed's long run economic projections released in September, that would put long-term bond yields around 4% – near current levels.

Without major changes to inflation and economic growth expectations, bond investors would expect to receive returns equal to bond yields. The aggregate bond index currently has a 30-day SEC yield (annualized) of around 4.25%.

Below-investment grade bonds, also known as junk bonds, yield more to compensate for the added risk of default or downgrade. Widely used indexes for these types of bonds are yielding around 6.25%, but these bonds are more volatile and move with equities if there is an equity market sell-off, so their diversification benefits are lessened. Investors gauge if they are expensive or cheap by looking at their spread over risk-free Treasuries. From this perspective, junk bonds appear expensive, but this also means investors have more confidence in the economy and don't expect a recession. We are cautious on high-yield bonds as spreads are tight, but we believe they could still be a valuable part of a balanced, diversified portfolio.

Figure 3: Range Bound Treasury Yields



Source: Cetera Investment Management, FactSet, U.S. Treasury Department. Data as of 9/18/2025.

The Bottom Line

The fourth quarter may mark an inflection point, with expectations for further Fed rate cuts—potentially in both late October and December—as labor market softness is forcing policymakers to act. While investors are optimistic about easing policy, the underlying reason for cuts is a slowing job market, raising the possibility of a “jobless expansion,” where economic growth continues despite weak employment growth. Equity markets may face increased volatility as investors digest mixed signals, but diversification could be rewarded, especially as sector and asset class leadership broadens beyond large-cap tech.

International equities are expected to remain a bright spot, supported by rate cuts from other major central banks, more attractive valuations, and a weaker dollar. However, risks persist in China due to structural issues, and in Europe and the Middle East due to geopolitical tensions. In fixed income, bond yields are expected to stay near long-term equilibrium levels—roughly equal to real GDP growth plus inflation—suggesting stable return potential, unless inflation or growth expectations shift meaningfully.

It is easy to get distracted by all the latest headlines. Diversification is prudent, and your Cetera financial professional can help you navigate any uncertainty, keeping you focused on your personal goals and objectives.

This report is created by Cetera Investment Management LLC. Follow [@ceteraIM](#).

About Cetera® Investment Management

Cetera Investment Management LLC (CIM) is a Securities and Exchange Commission registered investment adviser owned by Cetera Financial Group® (CFG). CIM provides market perspectives, portfolio guidance, model management, and other investment advice to its affiliated broker-dealers and registered investment advisers.

About Cetera Financial Group

“Cetera Financial Group” (CFG) refers to the network of independent retail firms encompassing, among others, those that are members [FINRA/SIPC](#); Cetera Advisors LLC, Cetera Wealth Services, LLC (f/k/a Cetera Advisor Networks), Cetera Investment Services LLC (marketed as Cetera Financial Institutions or Cetera Investors), and Cetera Financial Specialists LLC. Those that are Securities and Exchange Commission registered investment advisers; Cetera Investment Management LLC and Cetera Investment Advisers LLC. CFG is located at 655 W. Broadway, 11th Floor, San Diego, CA 92101.

Avantax Planning Partners, Inc. is an SEC registered investment adviser within the Aretex Group, Inc. (dba Cetera Holdings). All of the referenced entities are under common ownership.

Financial professionals affiliated with Cetera firms are either Registered Representatives who offer only brokerage services and receive transaction-based compensation (commissions), Investment Adviser Representatives who offer only investment advisory services and receive fees based on assets, or both Registered Representatives and Investment Adviser Representatives, who can offer both types of services.

The material contained in this document was authored by and is the property of CIM. CIM provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative and/or investment adviser representative is not registered with CIM and did not take part in the creation of this material. They may not be able to offer CIM portfolio management services.

Nothing in this presentation should be construed as offering or disseminating specific advice to any individual without the benefit of direct and specific consultation with a financial professional. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.

For more information about CIM, please reference the CIM Form ADV 2A and the applicable ADV 2A for the registered investment adviser your financial professional is registered with. Please consult with your financial professional for their specific firm registrations and available program offerings.

No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.

All economic and performance information is historical and not indicative of future results. The market indices discussed are not actively managed. Investors cannot directly invest in unmanaged indices. Please consult your financial professional for more information.

Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards. A diversified portfolio does not assure a profit or protect against loss.