



# Thinking Out Loud

## 3Q25 Update | Irrational Exuberance?

10/3/2025

### Bottom Line

Markets are showing remarkable resilience against a backdrop of political volatility, geopolitical shocks, and tariff overhangs. The Fed's cautious easing path, record earnings, and buyback momentum continue to support risk assets. However, systemic risks—from Gaza famine and Russian escalation to tariff shocks, softening employment and Fed independence concerns, burgeoning debt and shutdown uncertainty—create fragility beneath the surface. Equity market's base case remains muddle-through growth with ongoing market highs, but tail risks tied to policy missteps and global instability are intensifying, especially given highly stretched valuations.

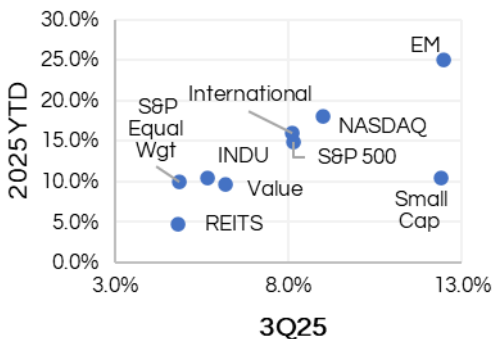
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### Capital Markets

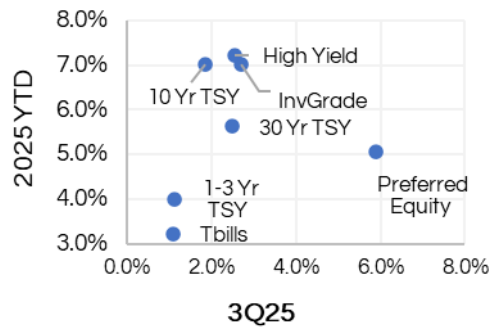
Despite political upheaval, markets remained resilient. The S&P 500 gained 2.2% in July, 2.0% in August, and 3.7% in September. Overall, the S&P climbed over 8% in 3Q25, a performance result that narrowly missed placement in the top 10% of all third-quarter total returns since 1988. Small caps returned 12.4% in 3Q, outdone only by EM Equities (+12.5%). The technology/growth-oriented NASDAQ returned 9.0% in 3Q25, followed by International (+8.1%). Q2 earnings for the S&P 500 rose over 13% YoY, according to SLEG/IBES, with revenue +6.4% YoY, setting records, despite firms absorbing tariff costs but warning of pass-throughs ahead. Corporate buybacks surpassed \$1T YTD, led by Apple (\$100B), Alphabet (\$70B), and Nvidia (\$60B).

3Q25 Equity Total Returns



FactSet and NEPCG

3Q25 Fixed Income Total Returns



FactSet and NEPCG

Preferred Equity posted a solid quarter, providing investors with a 5.9% total-return, increasing the YTD return to 5.1%. Investment Grade Corporates were 2.7% higher in the quarter, while Long-Duration Treasuries and High Yield Corporates, both returning roughly 2.5%. Overall, credit markets steadied with Bloomberg/Barclays Baa yields ending the quarter down 18bps at 5.0%, while HY (ICE BofA US High Yield Index) tightened over 30bps, to 7.06%, with commensurate spread tightening of 21bps (vs 10Yr). Safe-haven flows pushed gold above \$3,800/oz, Treasuries rallied, and the dollar weakened on Fed easing and growing potential fiscal risks. Oil prices mainly swung lower with supply headlines, somewhat supported by tight inventories.

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## Monetary Policy

The Federal Reserve delivered its first rate cut of 2025 on September 17, lowering the funds rate by 25 bps to 4.00–4.25%. This was the first cut in overnight borrowing rates since a 25-bps cut in December of 2024. The move was framed as risk management amid slowing payroll gains (+22k in August) and unemployment holding at 4.3%. Core PCE ran at 2.6% in Q2, with GDP revised up to 3.8% on firmer consumer spending. Governor Stephen Miran, the recent Trump appointee, dissented in favor of a 50-bps cut, raising concerns about Fed independence. Markets interpreted the September action as “cut-without-crash” easing, reinforcing soft-landing expectations.

## Fiscal Policy & Trade

Fiscal policy was dominated by Trump’s One Big Beautiful Bill Act (OBBBA) signed on June 30<sup>th</sup>, with VP Vance’s tiebreaker vote. The OBBBA cut \$1T from Medicaid and is projected, according to the Congressional Budget Office ([link](#)), to add \$3.4T to the deficit. The White House also rolled out a 10% baseline tariff regime on August 1, layering on specific deals with the EU (\$600B pledged investments, 15% auto tariffs), Japan (\$550B, tariff guarantees on chips and pharma), Vietnam (20%), and the UK (10%). Trump escalated further, announcing 30% tariff hikes on Mexican and EU imports effective August 1 and threatening Brazil with 50% tariffs amid Bolsonaro’s legal troubles. In early August, he also floated tariffs on pharmaceutical imports, initially described as “small” but with plans to scale to 150% within 18 months and potentially as high as 250%. That rhetoric hardened by late September, when the administration announced a sweeping 100% tariff on branded and patented pharmaceuticals effective October 1, with exemptions only for companies “building” U.S. manufacturing facilities. In the last weeks of the quarter, an additional 10% levy was placed on lumber and timber and 25% on cabinets and furniture. **Now that the government has officially shut down, potentially suspending BLS data releases, the Fed’s “data-dependent” approach is further complicated.**

## Geopolitical Developments

The quarter opened with the June 13<sup>th</sup>–24<sup>th</sup> Israel–Iran war, which left over 1,000 Iranians and 29 Israelis dead before a Trump-brokered ceasefire. Gaza’s humanitarian crisis deepened, culminating in an August 22 famine declaration affecting 500,000 people. In mid-July, Trump issued a 50-day ultimatum to Putin to accept a peace deal or face escalating tariffs and U.S. support for Ukraine. Putin rejected the terms, seized all of Luhansk Oblast, and intensified strikes on Kyiv. Trump’s August 15<sup>th</sup> Alaska summit with Putin—the first Western invitation since 2022—collapsed when Russia demanded annexation of all Donbas. Late September saw new flashpoints: Israel’s strike in Doha targeting Hamas leaders, Poland shooting down Russian drones, and naval escorts for Gaza-bound activists. U.S.–China tensions also grew as Washington extended chip export controls and Beijing steered its tech giants away from Nvidia’s China-specific GPUs.

## Domestic & Structural Events

Domestically, June and July brought unrest: protests and riots erupted in Los Angeles after ICE raids, Trump federalized the California National Guard, and severe floods in Texas killed 135 and caused \$18–22B in damages. Political tensions escalated further in August with Texas redistricting battles, defunding of the Corporation for Public Broadcasting, and Trump’s federal takeovers of local institutions. In September, Trump symbolically renamed the Pentagon the “Department of War,” while the Supreme Court allowed him to withhold

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\$4B in foreign aid and prepared to review the legality of unilateral tariffs. Structurally, the release of GPT-5 on August 7<sup>th</sup> marked a breakthrough in AI, with “PhD-level” reasoning and sharply reduced hallucinations, while the U.S. opened its first rare earth mine in 70 years. In Europe, September saw the launch of “Jupiter,” an exascale-class AI supercomputer powered by 24,000 Nvidia chips.

**We’d love to hear your thoughts.**

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