

## MARKET REPORT THIRD QUARTER 2025

### Key Points

- The environment is aggressive and unpredictable.
- The Top 10 companies in the S&P 500 represent 40.4% of the cap-weighted index.
- Yields declined and credit spreads tightened.
- Beware of Denominator Blindness.
- Many aspects of the current environment feel like standing on shifting sands.

### A Review of the Quarter

Cape buffalo are known to be aggressive when provoked and unpredictable. They live in tight-knit herds, will defend their own and are known to charge threats like, say, lions. As you visualize this scene in the African bushveld through your mind's eye, you may come to the conclusion that it looks eerily similar to the current political, economic, equity market and AI landscape.

Many elected officials, regardless of political affiliation, acted aggressively and unpredictably during the quarter. Fluid tariff policies were aggressive and unpredictable, creating near-term uncertainty. Interestingly, labor supply and demand weakened on similar trajectories during the quarter, minimizing imbalance. U.S. equity markets set new highs with value type companies participating in greater numbers while growth type companies' participation remained more concentrated. Animal spirits (i.e. non-rational, investor emotions) raged on, increasing the prospects for future aggressive and unpredictable equity market variability. Most anything related to AI behaved in an aggressive and unpredictable manner too. So, there you have it – our elected officials, economy, equity markets and most anything and anyone related to AI are

Total Return as of September 30, 2025						
	Annualized					
	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr
S&P 500	8.1%	14.8%	17.6%	24.9%	16.5%	15.3%
NASDAQ	11.4%	18.0%	25.5%	29.9%	16.1%	18.4%
<b>Russell 3000</b>						
Index	8.2%	14.4%	17.4%	24.1%	15.7%	14.7%
Value	5.6%	11.5%	9.3%	16.8%	13.9%	10.6%
Growth	10.4%	16.8%	24.8%	30.8%	17.0%	18.3%
<b>Russell Mid Cap</b>						
Index	5.3%	10.4%	11.1%	17.7%	12.7%	11.4%
Value	6.2%	9.5%	7.6%	15.5%	13.7%	10.0%
Growth	2.8%	12.8%	22.0%	22.9%	11.3%	13.4%
<b>Russell 2000 (Small Cap)</b>						
Index	12.4%	10.4%	10.8%	15.2%	11.6%	9.8%
Value	12.6%	9.0%	7.9%	13.6%	14.6%	9.2%
Growth	12.2%	11.7%	13.6%	16.7%	8.4%	9.9%

behaving like Cape buffalo: aggressive and unpredictable. To potentially increase the odds of a long-term, injury-free investment journey, consider remaining calm, not making sudden moves or throwing caution to the wind for fear of missing out. Discipline, process, the right temperament and considering context are all keys to long-term investment success, in our view.

## U.S. Equities

Equities (S&P 500) became slightly more expensive during the quarter as the average P/E multiple expanded. Profit margins, on average, remained near the highest level since 2002. The weight of the **Top 10** companies in the S&P 500 increased to **40.4%** from 38.2% last quarter. Investors gaining equity exposure by way of indexes may have greater single-stock risk than ever before yet may not be aware of that risk due to the passive nature of index investing. In addition, the **majority** of the Top 10 companies have significant exposure to generative artificial intelligence (“AI”), creating additional concentration risk.

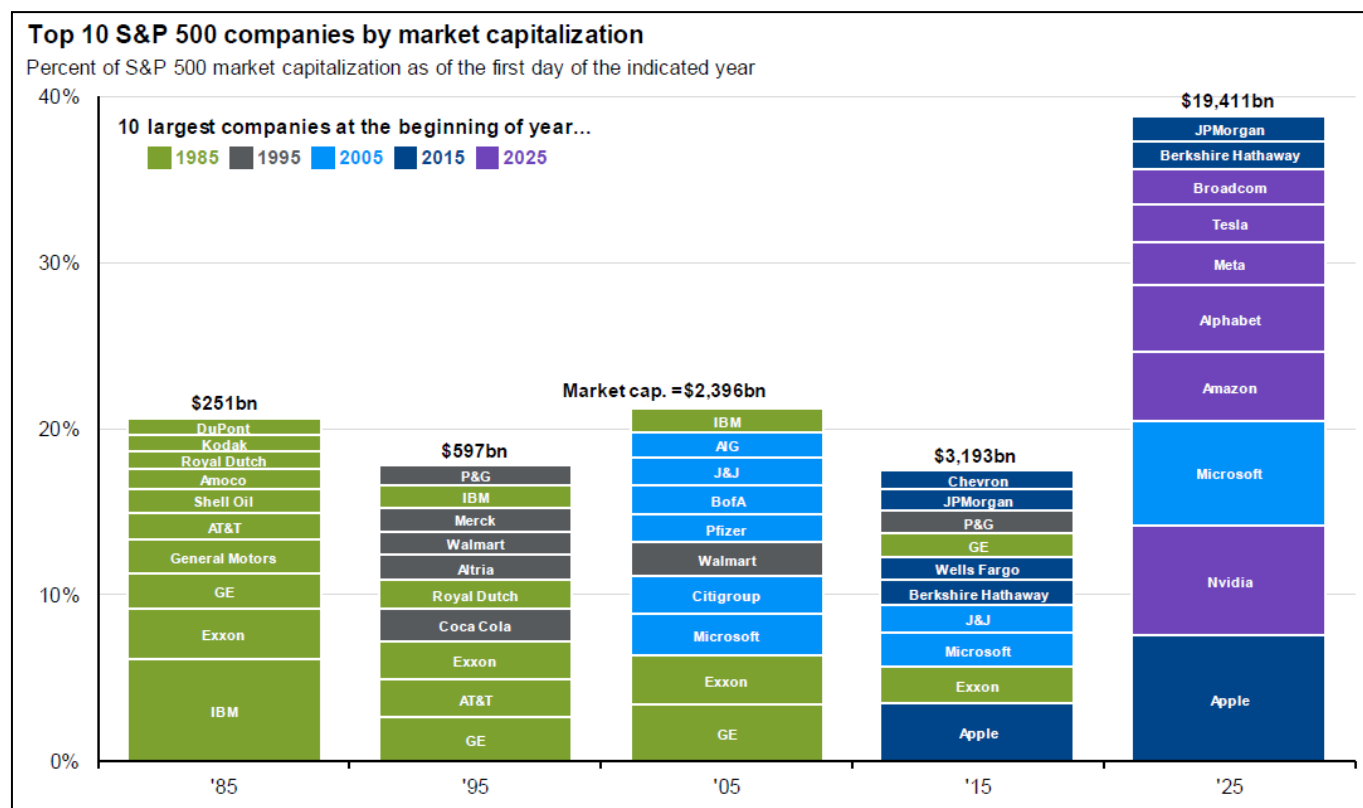
When crowds think something is a sure bet, “groupthink” is typically pervasive and can lead to a sudden reversal upon the slightest setback. The structure of our research group and research process, coupled with Midwest values and being 600 miles west of Wall Street, helps reduce our risk of succumbing to groupthink. We believe a lot of investment success can come from knowing what not to do and from zigging when others are zagging. Focusing on absolute-type returns and long-term compounding can result in portfolios being out of sync with the market.

While AI has the potential to, for example, significantly increase worker productivity, help discover new drugs and find cures for diseases, how the hyperscalers will monetize AI is yet to be determined or proven. Hallucinations or made-up answers are still a problem with Chat GPT-5, the latest GPT model, making up “10% to 20% of answers when asked about things it does not have access to,” as noted in the Wall Street Journal.

The productivity gains that can come from AI are impossible to fully comprehend so early in the process, but early indications suggest they could be substantial and can reshape how business is done. During the quarter, some corporate management teams began sharing how their companies and employees could be impacted. One large retailer stated, “Artificial intelligence will wipe out some jobs and reshape the company’s workforce.” Some new jobs will be created too.

Sometimes a picture can be worth many words:

## Top 10 Companies by Decade<sup>i</sup>



Note that only JP Morgan, Berkshire Hathaway and Apple were in the Top 10 a **decade prior** and **none** of the current Top 10 were in the Top 10 before 2005. Also, note the size disparity, as illustrated by the height of each block relative to past decades – noteworthy.

Clean energy industry braces for the end of U.S. subsidies. Under the One Big Beautiful Bill Act (“OBBBA”), residential, commercial, and automotive subsidies end this year or are phased out in future years. When industries are heavily supported by politically charged subsidies, a change in administration and policy can impair those industries. We generally avoid meaningful exposure to such industries, much like we typically avoid business models requiring routine access to significant amounts of external capital for daily operations.

Currently, hardware companies are benefitting handsomely from the AI infrastructure buildout. Platform companies should be next in line as infrastructure is completed, if an adequate return can be earned on the enormous amounts of capital invested. Then, beneficiaries (users) should begin to fully benefit through increased productivity. Much like with past technological shifts, some job functions will change, and many employees will be retrained.

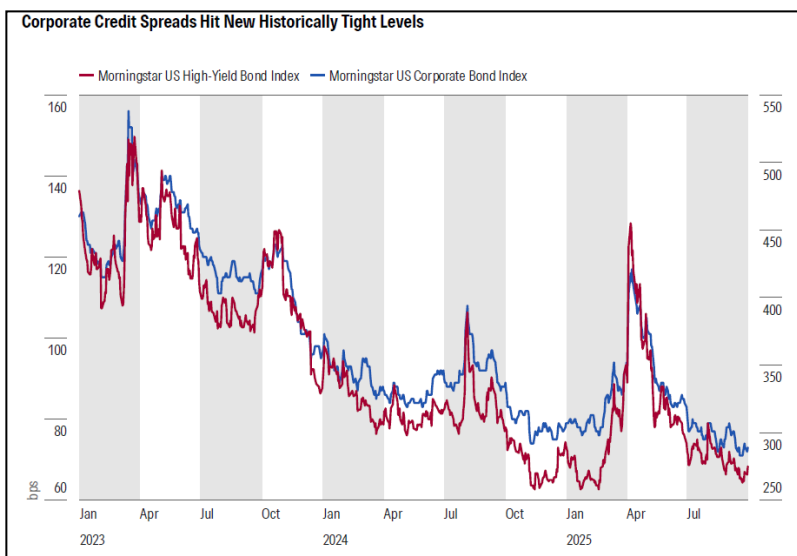
## Fixed Income & Commodities

After holding the Fed Funds rate steady for five consecutive meetings, the Federal Open Market Committee (“FOMC”) lowered the rate 0.25% to **4.25%** on September 17. Markets anticipate additional rate cuts before year-end, but data should ultimately guide the FOMC’s decision.

Total Return as of September 30, 2025						
<i><b>Fixed Income</b></i>	Annualized					
	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr
ML U.S. Corp. 1-10 Yrs	2.1%	6.6%	5.2%	7.1%	1.8%	3.2%
ML U.S. Tr./Age. 1-10 Yrs	1.3%	5.2%	3.5%	4.4%	0.4%	1.6%
<i><b>Commodities</b></i>						
Bloomberg Comm. Index	3.6%	9.4%	8.9%	2.8%	11.5%	3.9%
Oil (WTI)	-4.2%	-13.0%	-8.5%	-7.8%	9.2%	N/A

On the bond front, yields declined across maturity and credit spectrums during the quarter with maturities of one-year and less declining the most. Our income strategies benefited from declining yields (recall there is an inverse relationship between a fixed-income instrument’s yield and price) and tightening credit spreads.

Corporate credit spreads (i.e. number of basis points a corporate instrument yields over a corresponding Treasury to compensate for corporate default risk) for investment grade bonds (left scale, blue) and high-yield bonds (right scale, red) in the chart<sup>ii</sup> to the right remain **very tight**. In other words, corporate bonds are expensive relative to historic average credit spreads. We are prepared to capitalize on opportunities should credit spreads widen relative to our holdings. For additional context of the bond market’s current state, consider this: Around quarter-end, the AAA-rated corporate bond of a major software company yielded **less** than its corresponding Treasury – creating a negative spread. Unusual.



High yield bonds, which are not a primary focus of our income strategies, have only traded at a tighter spread “less than 3% of the time since 2000,” according to Morningstar.

We have been in a very positive investment environment for an extended period of time with generally accommodative monetary policy and a healthy dose of optimism. Those factors can

lead to excesses and poorly underwritten deals coming under stress if the economy slows. Historically, the worst loans are often made in the best of times and vice versa.

**Commodities**, as measured by the Bloomberg Commodity Index, rose during the quarter (see top chart on previous page). Oil's (WTI) weakness continued, helping mitigate inflation.

### **Denominator Blindness**

A fraction is made up of two parts: The numerator (top number) and denominator (bottom number). The numerator represents a certain number of units of a data set. The denominator illustrates all the units in the data set or the whole.

Denominator blindness can occur when only the **raw data** (numerator) is illustrated in a headline, presentation or conversation without being compared to the denominator. Showing only the numerator can be designed to grab the reader's attention or evoke an emotion and can be **misleading**.

For example, a headline reads S&P 500 down 200 points and you think to yourself, "that's a lot." However, as of September 30, 2025, that would have only equated to a 3.0% decline ( $200 / 6,688$ ), hardly a crisis. What about the cocktail party conversationalist who shares, "my portfolio was up \$250,000 last year?" You think, "that sounds pretty good." Well, was it initially a \$3,000,000 or \$5,000,000 portfolio, returning 8.3% or 5.0%, respectively? Was it a diversified stock portfolio, a concentrated stock portfolio or a portfolio of roughly half stocks and half bonds?

What about corporate layoffs? Headline reads, "Company X laid off 5,000 today." Did company X employ 10,000 or 1,000,000 people, resulting in 50% or 0.50% being laid off, respectively?

**Without context**, investors may misunderstand risk. When risk is misunderstood, it can lead to poor investment decisions: sometimes in the form of taking too much risk and in other times not taking enough to meet long-term investment objectives.

So, when someone shares a big number with you or a headline grabs your attention, consider searching for the denominator to better understand the magnitude of the situation at hand.

### **Looking Ahead**

Someone once said, "business is like standing on shifting sand." The same analogy can currently be applied to many societal, political and regulatory norms. On the heels of COVID, the U.S. workforce's concept of work-life balance seemingly took on a whole new meaning – focused more on balance and less on work. Some large corporations changed their narrative during the quarter, becoming brutally honest about weekly work expectations. This may prove to be a net positive for America in the coming years and a reminder that having an opportunity to work is a privilege.

The push to make private equity investments available in 401(k) plans for the masses is fraught with issues such as fee, liquidity and valuation considerations, but with an estimated \$13 trillion invested in defined contribution plans as of mid-year – private equity sponsors have a lot of incentive to push ahead. High fee structures could be a barrier until guidance is provided, as plan sponsors may have concerns about litigation risk.

Plans to loosen U.S. bank regulations are well underway, and if successful could free up an estimated \$140B in capital for Wall Street lenders and unlock \$2.6 trillion in lending capacity, according to the Financial Times. Bank deregulation is a part of the Administration's plan to reduce the budget deficit to 3% of GDP, while achieving 3% real growth – by shifting growth into the private sector and having banks take on a larger role in funding that growth. Regardless of the prospects of achieving that goal, deregulation is the first step. Some unintended consequences are likely in the years ahead, like increased risk taking and aggressively underwritten loans.

*Past performance is not indicative of future results and all investments involve some degree of risk. Market and economic data have been provided by third party sources. This data, while believed to be reliable, has not been independently verified by EBS.*

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<sup>i</sup> Guide to the Markets ® - U.S. 4Q 2025

<sup>ii</sup> Q4 2025 North America Market Outlook