

Investment Market Review October 2025

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U.S. stocks advanced during the third quarter, overcoming pockets of volatility fueled by ongoing uncertainty surrounding global tariffs. The S&P 500 finished the quarter just shy of an all-time high and is up 14.8% for the year — a strong showing given the policy headwinds and uneven economic signals investors faced along the way.

Valuations continued to draw attention as prices rose faster than earnings. The S&P 500's price-to-earnings (P/E) ratio pushed toward multi-decade highs and now stands roughly two standard deviations above its 30-year average. While elevated, valuations remain below the peaks reached in the late 1990s during the "dot.com" bubble. Earnings growth expectations have helped justify these levels. Analysts forecast roughly 10% earnings growth for 2025 and low double-digit gains in both 2026 and 2027. That optimism, supported by resilient corporate margins and steady economic growth, has kept investors willing to pay a premium for future profits.

Market concentration reached new territory. The ten largest companies in the S&P 500 now account for about 40% of the index's total market capitalization — twice their historical average since 1985. This growing dominance highlights the influence of the "Magnificent 7," whose collective performance continues to shape overall index returns. The same dynamic that lifted markets in recent quarters also presents a risk: when such a small group of stocks carries so much weight, any disappointment in their earnings or guidance could have an outsized effect on the broader market, particularly cap-weighted index funds.

Sector performance was broadly positive during the quarter. All S&P 500 sectors except consumer staples posted gains, with technology leading the way once again. The enthusiasm surrounding artificial intelligence (AI) remained a key driver, as companies increased capital expenditures to build data-center capacity and produce next-generation chips. Partnerships announced between OpenAI and several major tech firms illustrated both the scale of investment required and the confidence in AI's transformative potential. Yet, the rapid pace of spending raises an important question: can demand for AI applications keep up with the supply being built, and will it translate into sustained, profitable growth?

The Federal Reserve cut the federal funds rate by $\frac{1}{4}$ percentage point at its September meeting, its first reduction this year. Policymakers cited emerging downside risks to employment, even as inflation remains somewhat above the 2% target. The move suggests the Fed sees enough progress on inflation — and enough cooling in the labor market — to begin normalizing policy. Both the Fed and market participants anticipate rates drifting towards the lower end of the 3% range by the end of next year. A gradual decline in rates should help ease borrowing costs for businesses and consumers, supporting continued expansion into 2026.

Meanwhile, fiscal policy again captured headlines. Congress failed to pass a funding bill before the September 30 deadline, triggering a partial government shutdown on October 1. The sticking point centers on enhanced Affordable Care Act (ACA) subsidies. Despite the looming deadline, financial markets showed little concern during the final weeks of the quarter, reflecting the belief that the shutdown would be brief and largely symbolic. Even so, prolonged political standoffs risk eroding confidence and could weigh on growth if they persist.

The third quarter highlighted the market's remarkable ability to look through short-term uncertainty. Investors have shrugged off tariff debates, inflation concerns, and fiscal dysfunction, focusing instead on strong earnings trends and the ongoing productivity story tied to technology and AI. While this resilience is encouraging, it also suggests that expectations are high. With valuations stretched and concentration at record levels, the margin for disappointment has narrowed.

As we enter the final quarter of the year, the outlook remains cautiously optimistic. Economic growth is steady, inflation is trending lower, and corporate earnings continue to expand. Yet, elevated valuations and political uncertainty warrant vigilance. For long-term investors, the environment reinforces familiar lessons: stay diversified, emphasize quality, and resist the temptation to react to headlines. Over time, markets tend to reward patience and discipline.