



Quarterly Investment Newsletter - Issue 15



Mike Horwath, CFA® | Chief Investment Officer

A Nightmare on Wall Street?

The calendar has turned to Autumn, football is back, and the weather is fantastic here in the northeast part of the country. Despite my hatred for scary movies (I'm a wimp and I know it), I'm loading up the Halloween-themed puns and digging into what has been an eventful nine months of 2025.

Many of you are staring at your investment accounts and seeing values well into the positive from where you started the year. Given the strong returns across financial markets this year, it's sort of a weird question to pose in a title for a newsletter, right? On one hand, it's a catchy name for one of the least creative humans on the planet. In that same vein, there is plenty to like with regards to corporate fundamentals and the trajectory of artificial intelligence (AI) investment. On the other hand, the strong contingent of economic conditions that we have seen in the last couple of years is starting to show signs of pockets of weakening.

Let's reconcile these two diverging areas and discuss how we're positioning ourselves going into the end of the year.

P.S. – for those of you who want a quick summary, feel free to scroll to the end.



A Not-So-Spooky Market

If Ghostbusters was a legitimate horror film, this year's stock market would be the equivalent to that. That's to say, it hasn't been all that scary. Despite the quick pullback in March/April and all the other considerations in economic conditions and global policy, it is safe to say this year has been beneficial for owners of risk assets, especially stocks. Below is a good summary of market returns as we turn the page to the fourth quarter...



Market and Economic Chartbook | October 1, 2025



Global Market Summary

Global stocks, U.S. sectors and interest rates

Global Stock Market Summary

Index	Level	WTD	MTD	QTD	YTD
S&P 500	6688	0.7%	3.5%	7.8%	13.7%
Dow Jones Industrials Average	46397	0.3%	1.9%	5.2%	9.1%
NASDAQ Composite	22591	0.5%	5.3%	10.9%	17.0%
MSCI Emerging Markets Index	1346	1.5%	7.0%	10.1%	25.2%
MSCI EAFE Index	2767	0.9%	1.6%	4.2%	22.3%
MSCI All Country World Index	984	0.8%	3.5%	7.3%	17.1%
MSCI Europe Index	2496	1.1%	1.9%	3.3%	24.6%

Sector Performance

Index	WTD	MTD	QTD	YTD
Healthcare	2.7%	1.6%	3.3%	1.2%
Technology	1.4%	7.2%	13.0%	21.7%
Industrials	1.1%	1.7%	4.6%	17.1%
Materials	1.0%	-2.3%	2.6%	7.7%
S&P 500	0.7%	3.5%	7.8%	13.7%
Utilities	0.5%	4.0%	6.8%	15.1%
Real Estate	0.4%	-0.1%	1.7%	3.5%
Cons. Stap.	0.4%	-1.8%	-2.9%	2.0%
Financials	0.0%	0.0%	2.9%	11.5%
Cons. Disc.	0.0%	3.1%	9.4%	4.7%
Comm.	-0.9%	5.5%	11.8%	23.7%
Energy	-3.0%	-0.5%	5.3%	4.3%

Global Rates Summary

	Sep 30, 2025	Aug 29, 2025	Jun 30, 2025	Dec 31, 2024
3-Month Treasury Yield	4.02%	4.23%	4.41%	4.37%
2-Year Treasury Yield	3.60%	3.59%	3.72%	4.25%
10-Year Treasury Yield	4.16%	4.23%	4.24%	4.58%
30-Year Treasury Yield	4.73%	4.92%	4.78%	4.78%
30-Year Fixed Mortgage	6.30%	6.56%	6.77%	6.85%
German 10-Year Bund Yield	2.71%	2.72%	2.61%	2.37%

Currencies and Commodities

Index	Level	MTD	QTD	YTD
US Dollar Index	97.78	0.0%	0.9%	-9.9%
Euro	1.18	0.4%	0.1%	13.5%
Chinese RMB	7.12	0.2%	0.7%	2.5%
Japanese Yen	147.69	-0.6%	-2.2%	6.0%
British Pound	1.35	-0.4%	-1.8%	7.5%
WTI Oil	63.17	-1.8%	-4.7%	-12.8%
Brent Oil	68.00	-0.2%	0.5%	-9.0%

Sources: Clearnomics,
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As you can see, both stocks and bonds have driven portfolios predominantly higher this year. Below is how I would summarize the major themes of the year:

1. **A focus on corporate fundamentals:** In the early part of the year, the announcement of tariff policy and future uncertainty dominated headlines and ultimately pushed asset prices down.

Since mid-April, the market's strength has been driven largely by strong earnings growth and profitability, as companies have reported rising revenues and margins, while valuations have also expanded as investors are willing to pay higher multiples for those earnings. It took the U.S. market a total of 55 trading days to recover the nearly 19% drawdown that ended in April (source YCharts). In short, the focus has turned to corporate earnings, future earnings, and AI spending.

2. **International stocks outperforming the U.S.:** The combination of a depreciating dollar, cheaper valuations, and capital flows have led to a strong international stock market this year. Investors diversified into international stocks have largely benefited as indexes like the MSCI EAFE (non-US developed) and MSCI Emerging Markets (non-US emerging) have outperformed the S&P 500 on the year.
3. **Bonds well into the positive:** Bonds have been contributing to portfolio returns. One of the questions we received over the last couple of years was whether there was value investing in bonds over short-term money market. With bond markets up roughly 6% this year, I think that question has been answered.

On the surface, investors are seeing diversified returns from various asset classes, interest rates are dropping, and global growth is being revised higher. Nothing spooky about that. Why is it then that consumer sentiment is so weak across expectations of business conditions, inflation, personal finances, and the labor market? While the title of the newsletter is a bit facetious, I think there are multiple truths in markets right now that are pulling both investors and consumers in diverging directions. I think it's worth spending some time uncovering those truths to gain some perspective on why markets are acting the way they are...

Trick or Treat – Investment Edition

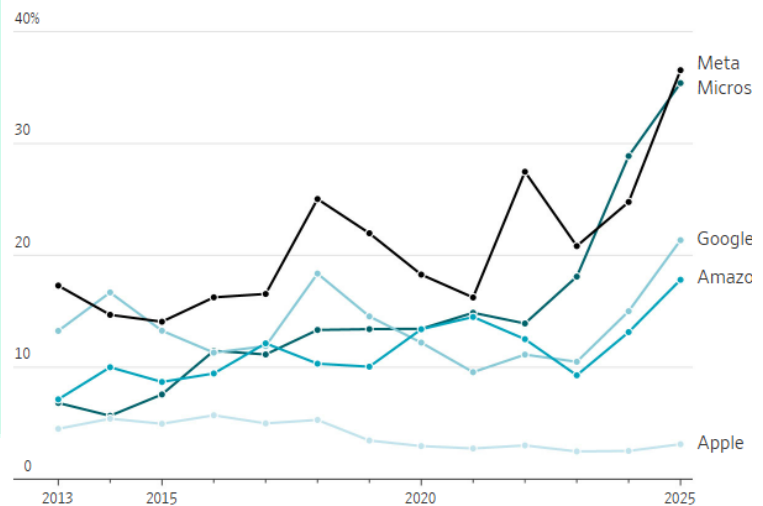
For someone who refuses to listen to me, my daughter listened really well when I explained what happens after she says “trick or treat” on Halloween. After ingesting several pounds of Hershey’s and Reese’s, we suddenly want to say the phrase the other 364 days of the year. Sugar levels and cavities aside, let’s play a little game of Trick or Treat with common questions we get from our clients. I think this exercise will be helpful in highlighting the areas we find attractive (we’ll call it Treat) and the pockets we have some concern (naturally the Trick).

- **AI is the driving force behind the bull market in stocks.**

TREAT – All aboard the AI train! In most markets, there are several “themes” working all at once across various industries and sectors. The market today has a similar feeling to the late 90s, where the internet dominated conversations and seemingly drove most, if not all, movement in stock prices.

Investors, both professional and retail, continue to frantically find the most optimal places for their capital as investment into AI and necessary infrastructure explode. Similar to the internet, there will be winners and losers and investors jumping into a lot of these stocks need to be comfortable with that expectation. The hope is that AI will create a technological revolution to increase productivity and open new doors to innovation. In a world where demographics are becoming challenging for labor supply, productivity growth sounds great. That said, there are a lot of unknowns with this level of investment and what the ultimate ROI will look like. Which industries and jobs will be most affected? The leaders in capital investment are the major technology companies, like Meta, Microsoft, Google, Amazon, and Oracle. Companies in the semiconductor (Nvidia for example), energy, and infrastructure industries have also benefited as the energy and chips needed for this change are massive. There is a lot to be excited about in this new technology, but plenty of uncertainty comes with it.

Capital expenditures as a percentage of sales, yearly



Note: 2025 shares based on estimated full-year expenditures and sales figures. Data are for calendar years. Sources: the companies (expenditures and sales through 2024); the companies and Visible Alpha (2025 estimates)

For now, the most profitable companies on the planet are investing a lot of their free cash flow into building this out. The stock market has rallied on hopes of economic, productivity, and earnings growth across many industries. Unlike the internet of the late 90s, the biggest companies benefiting are also some of the most profitable today from an earnings perspective. That said, we’ve begun to

see unprofitable (and even sometimes pre-revenue) businesses taking off on speculation of what the future may hold. That is a concern, and frankly something we tend to avoid as much as we can in our portfolios.

The investment freight train isn't likely to stop soon, but there will be ebbs and flows as we move forward. We have some concerns over the markets being so reliant on one theme and valuations have started stretching themselves. This revolutionary technology promises to bring foundational change across many businesses, but investors shouldn't lose sight of the volatility that can, and likely will, come with that.

- **The stock market rally proves that the economy is firing on all cylinders.**

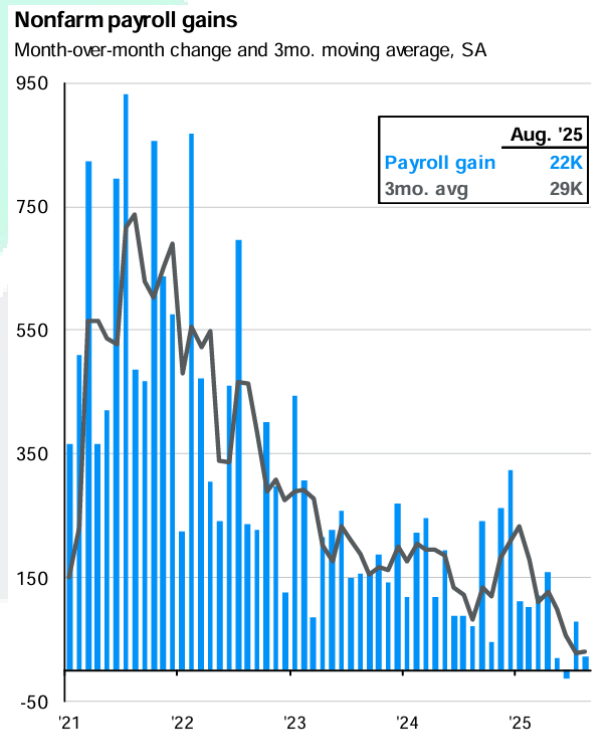
TRICK – Here is an important concept...the stock market is NOT the economy. There is plenty of overlap and interplay between the two, but extrapolating an opinion on one from the other isn't as obvious as many would think.

There is plenty to like in economic conditions...corporate fundamentals are still solid (earnings, margins, debt levels), inflation is behaving, and consumer health has been resilient. All good things!

Stock market returns would lead you to believe that everything is clicking but we're just not seeing that presently. First and foremost, the labor market is weakening. You can see that payroll gains have methodically been dropping, and past revisions have been mostly in the downward direction. Demographics across the world will make labor supply a challenge in the future decades but, for now, we're already seeing an impact on the supply side.

The other consideration we're focused on is something called the "soft data," which we've brought up before. This refers to the sentiment side of markets, which aren't always perfect but do help get inside collective feelings. What we're seeing is the average person not feeling great about the future of business conditions, inflation, and personal finances. We're a consumer-driven economy and we need consumers confident to spend and promote growth. A weak sentiment puts us on alert for changes in behavior and their future impact on top-line revenue.

A key nuance here is when you look at sentiment broken down by income level. The wealthy largely feel great while the lower income households are on the complete opposite end.

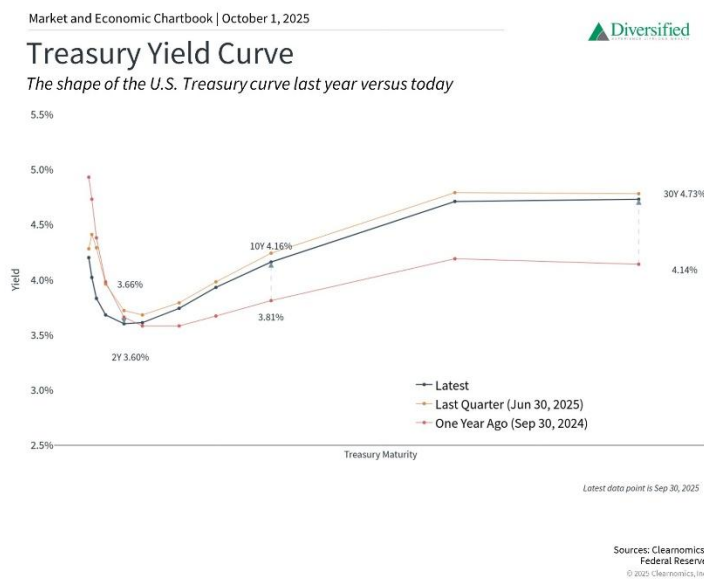


Source: BLS, FactSet, J.P. Morgan Asset Management.

One key item we've noticed is that GDP growth domestically in the first half of the year wasn't predominantly driven by the consumer. We're seeing business spending, which is historically less than 15% of GDP, driving an outsized share of that growth. Is that sustainable? Can the US continue to rely on AI business spending when the consumer isn't pulling their weight, per se? Time will tell but right now several parts of the economy have us keeping a close eye on any major changes.

- **The Federal Reserve (the Fed) is just starting a new cutting cycle.**

TREAT – My prediction coming into the year was for three rate cuts, totaling 75bps (0.75%). For much of this year, market expectations supported a more restrictive, slower pace of cutting than what I had predicted. Candidly, I agreed with that evaluation in the earlier part of the year.



The short answer is that the Fed anticipates a gradual rate cutting process for the next 18 months or so. The question we often get is whether we think the Fed will wait too long to cut rates. My answer is “probably yes.” This isn’t necessarily a critique of their job as I think the collective decisions have been sound, but rather an emphasis on how difficult their job is. A lot of the data they depend on is rear-facing, and relying on that certainly presents the challenge of being too late. Policymakers have emphasized a data-dependent approach, balancing the risks of

cutting too soon—which could reignite inflation—with waiting too long, which could dampen economic activity and strain credit markets. It’s a fine line.

With inflation relatively stable and the labor market weakening, the data has shifted to supporting a slow cutting cycle. For perspective, the markets are pricing in the highest expectation of rates being at 3% at the end of 2026, meaning a total of 1% in additional cuts by the end of next year.

What's the impact? Investors who have chosen to sit on cash are going to yield less over the next year. Savers in general will be negatively affected on the fixed income and cash side of things. On the other hand, debt will slowly become cheaper and ideally support business growth and homebuyers.

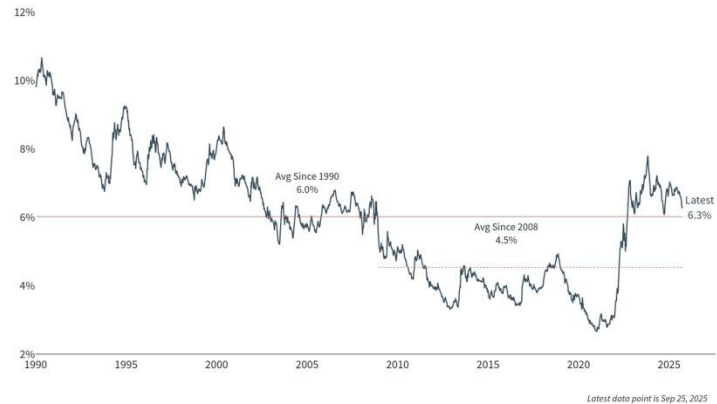
For now, I'd consider this a treat for the economy, but potential risks are plenty. For us, our focus is still on any residual impact of tariffs, especially on the inflation front.

Market and Economic Chartbook | October 1, 2025



Mortgage Rates

30-Year Fixed Rate Mortgage



Sources: Clearnomics, Freddie Mac
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- **The effect of tariffs has proven to be lighter than expected.**

TRICK – After the “Tariff Tantrum” in early April, stock markets have largely ignored the uncertainty around import taxes. That has been for most good reasons as corporate earnings, and earnings expectations, have proven resilient with increasing estimates. Most of the discussion up to this point has been on the revenue created for the government, which was well over \$100 billion through September. Did markets and the media overstate the potential impact of tariff policies?

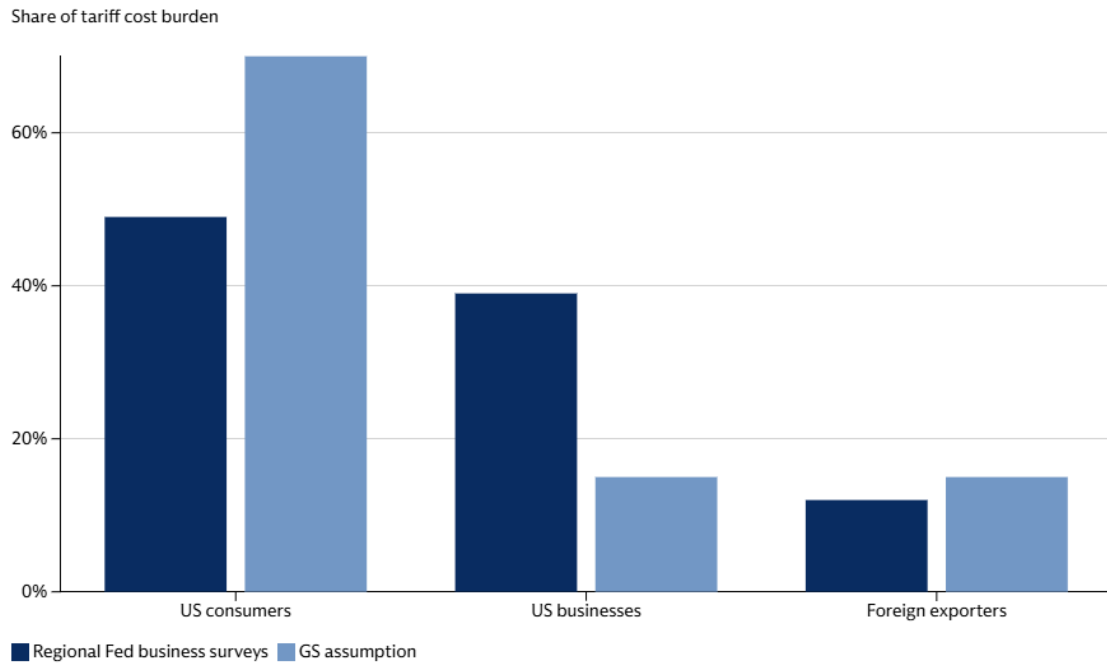
The simplest answer is that we likely don't know yet. From our perspective, we still believe that tariffs and trade policy could be the monster hiding in the closet. There are a couple of possible explanations for why tariffs haven't hit prices or consumption too hard yet:

- The economy and consumers have been strong enough to offset any effects of trade policy.
- Businesses came into the year with very strong profit margins and have either been able to absorb any increase in cost or they've been able to hold off increasing prices while selling inventory that was acquired at pre-tariff prices.

This is probably an overly simplistic breakdown, but we tend to focus on the second one. You can see from the graphic here that Goldman Sachs anticipated about 70% of tariffs would be passed onto the consumer via higher prices. Up to this point, it appears that businesses have been willing, or able, to absorb those increases. Once lower cost inventory rolls off or margins start getting squeezed, it's reasonable to assume some price increases will be passed onto the consumer. At that point, we're going to focus on the path of inflation (and the Fed's

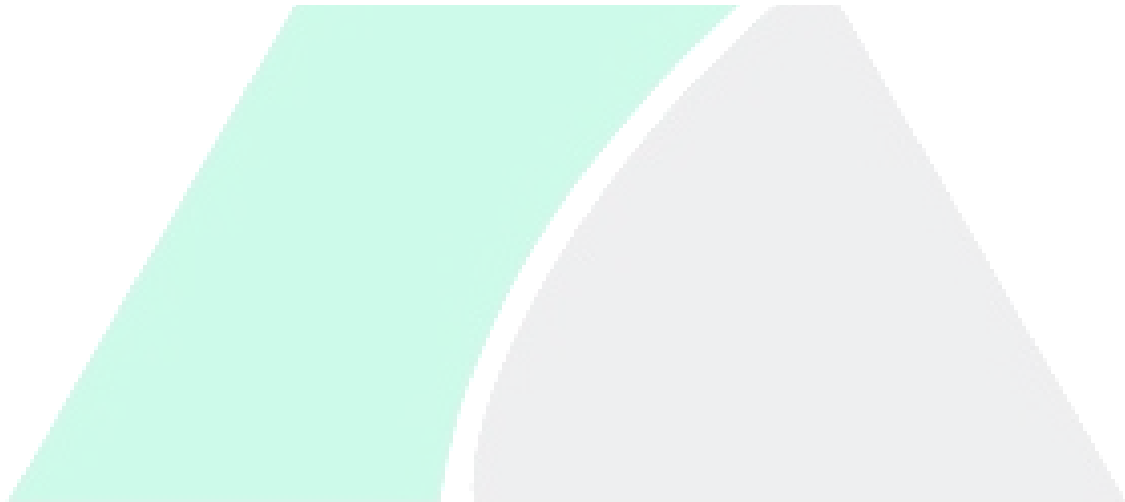


response) and any demand destruction. We expect a lot to still play out on the trade front as many trade deals are still in the works.



Source: Federal Reserve, Goldman Sachs Research

**Goldman
Sachs**



Pumpkin Spiced Portfolio Positioning

I can only imagine the pain in your face after another brutal autumn reference. I get it and I'm sorry.

We can look at all the charts and data we want, but the most important details are in how we're positioning portfolios given the information at hand. Let's start with the major comments around asset classes, our views, and what we have heightened concerns over.

Markets, Stocks, and Bonds – General Comments:

- **There is still a lot to like:** A lot of this newsletter has been committed to tempering expectations and acknowledging the risks and concerns within the economy. Let me start by saying there is a lot to still like in owning risk assets, namely equities, right now. The combination of corporate fundamentals, AI-induced tailwinds, dropping rates, and fiscal stimulus make it hard to bet against stocks right now. Both corporations and consumers, on average, hold balance sheets that are an attractive starting point. Markets often follow earnings, and we continue to see earnings expectations grind higher.
- **The economy is good, not great:** I had the pleasure of presenting to the clients in one of our offices last month and I used the phrase "good, not great" all too often. It is probably the phrase I would use if I needed to describe the economy in three words. Many of the areas we've already discussed are on solid ground, such as growth, spending, business investment, and inflation. Outside of business investment, I wouldn't describe any as great right now. In addition, the labor market is ground zero for concern as job growth and labor supply have slowed considerably.
- **Risks are building:** There are always risks in investing and nothing is ever a sure thing, so this statement could be said at any time. As we sit here today, there are a few key points that we're increasingly focused on. First, prices are rich. We always say that price matters and the cheaper you buy something, the more margin you have for things to go wrong. At nearly 23x forward earnings, the S&P 500 has a lot of growth and optimism priced in so our margin for error is lower than we'd like. Second, it's been said several times here, but the labor market is clearly starting to weaken. Can productivity growth help offset some of the labor struggles to keep pushing growth? Lastly, will tariffs begin to be passed through to the consumer and reignite inflationary concerns?

Portfolio Positioning & Thoughts:

So how are we thinking about portfolio positioning right now? For those of you who have read these in the past (thank you for that!) will see some of the same themes with a little bit new.

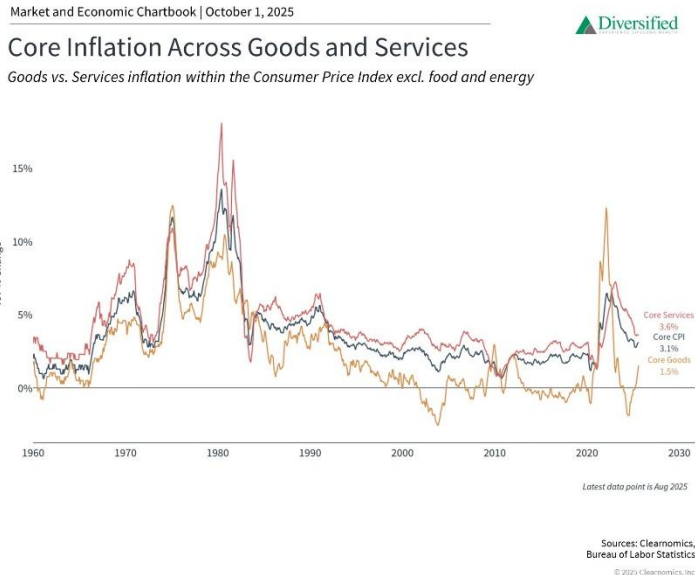
- **Up in quality:** In our opinion, there are times for ratcheting up risk within portfolios and other times to dial it back. We can accomplish this in several ways across both stocks and bonds. It shouldn't be a surprise for me to say that we're tilting a bit more defensive today and staying up in quality.

Within equities, we continue to lean into US large cap stocks. When we follow corporate fundamentals, the largest US companies are the ones with the overall best earnings growth, profitability, and sensitivity to the AI theme. While US small cap stocks are trading relatively cheap to large cap, we're not seeing earnings growth or economic activity at levels that give us confidence in a major rally. In a time when US large cap valuations are expensive, both small cap and international will offer cheaper diversifiers but most of our positioning leans to the largest part of the US market.

The fixed income positioning largely follows that same theme. One of the ways we can toggle risk within bonds is to focus on the credit quality of the portfolio. With corporate fundamentals so strong right now, credit spreads are very tight. That means that investors aren't getting much compensation in return for taking on additional credit risk (buy debt of a less credit worthy business). With that being the case, we're heavily weighted towards investment grade debt through the combination of government treasuries, securitized bonds, and corporate debt.

- **Hedging for inflation risks:** It's been mentioned several times in this newsletter, but our belief is that inflation risks are to the upside rather than the downside. We're not calling for hyperinflation, so I want to keep that in perspective, but there are several structural forces at play here. First, tariffs have not been fully felt by the consumer and price increases could

push short-term inflation higher. Second, a strong economy with limited labor supply could push a wage-price spiral. We're not making a major bet on higher-than-expected inflation but rather adding pieces to the portfolio to manage that risk.



The good news is that stocks have traditionally been strong performers on a “real” basis, meaning net of inflation. While past performance isn't

indicative of future results, we believe that equities will continue to help investors keep up with price increases.

The bond side is our bigger concern, as fixed income tends to be hit harder by higher-than-expected inflation (think 2022). To help manage that, we've adjusted many portfolios to include a treasury inflation-protected securities (TIPS) position. That allows us to maintain a high-quality government bond allocation that has a return component tied to movements in inflation.

In Summary...

Market Overview: 2025 has been a strong year (in terms of returns) for financial markets, with both stocks and bonds delivering positive returns. Despite a brief pullback in March/April, corporate fundamentals and AI-driven optimism have fueled a robust recovery. International equities have outperformed U.S. markets, and bond investments have proven valuable again.

Key Themes:

- **Corporate Fundamentals:** Earnings growth and profitability have driven market strength, with investors paying higher valuations for solid performance.
- **AI Investment Boom:** AI is the dominant market theme, reminiscent of the late 1990s internet era. Major tech firms and infrastructure sectors are leading the charge, though speculative investments in unprofitable companies raise concerns.
- **Economic Divergence:** While markets are strong, economic indicators show mixed signals. Labor market weakness and poor consumer sentiment contrast with solid business spending and stable inflation.
- **Federal Reserve Policy:** The Fed is expected to continue a slow rate-cutting cycle. While this supports growth, risks remain if cuts are delayed or inflation resurges.
- **Tariff Uncertainty:** Despite limited immediate impact, tariffs may still pose inflationary risks once businesses exhaust pre-tariff inventory and margins tighten.

Portfolio Positioning:

- **Quality Tilt:** Portfolios are positioned defensively, favoring U.S. large-cap equities, dividend growers, and investment-grade bonds.
- **Inflation Hedging:** Treasury Inflation-Protected Securities (TIPS) are included to manage upside inflation risks.
- **Cautious Optimism:** While fundamentals support continued equity exposure, elevated valuations, labor market concerns, and potential inflationary pressures warrant a measured approach.

As we head into fall and Halloween, there is plenty to be scared about when considering risks in markets. A government shutdown? A weakening labor market? Risks to inflation? Just remember that we build portfolios to align with long-term planning objectives and make measured adjustments over time to account for a lot of these risks and changes. You know where to find us if you have any questions or want to revisit our collaborative plan. As always, thank you for the trust you put in the Diversified team!

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S&P 500: The Standard & Poor's 500 Composite Stock Price Index is a capitalization-weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the U.S. economy. Stocks in the Index are chosen for market size, liquidity, and industry group representation.

Russell 2000: The Russell 2000® Index is a capitalization-weighted index designed to measure the performance of the 2,000 smallest publicly traded U.S. companies based on in market capitalization. The Index is a subset of the larger Russell 3000® Index.

MSCI All Country World Index: The MSCI ACWI captures large and mid-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. With 2,937 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. With 695 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.*

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries. With 1,203 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.*

The Bloomberg US Aggregate Index is a broad-based benchmark that measures investment grade, US dollar-denominated fixed-rate taxable bond market.

The Bloomberg Municipal Index is a measure of the US municipal tax-exempt investment-grade bond market.

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