

Quarterly Market Wrap | Q3 2025

Fed-Fueled: Quintuple Record Highs in Q3

FTWA



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The unprecedented market rally soared to new heights in the third quarter of 2025, defying the phenomenon historically known as the “September Effect,” which marks September as the weakest month for stock returns. The three major large-cap indexes, the Russell 2000 small-cap index and gold continually surpassed previous records.

A supportive Federal Reserve and booming artificial intelligence continued to sweep across industries, driving market gains as corporate earnings defied macroeconomic and geopolitical headwinds. Although the AI frenzy continued to fuel investor enthusiasm, the bull market extended well beyond tech giants, showcasing resilience through pivotal third-quarter events.

- 1. Major U.S. indexes notch new record highs:** All three major U.S. large-cap indexes continued to rally. Boosted by incredible gains from corporate giants like Nvidia and Intel, the S&P 500, Nasdaq and Dow Jones Industrial Average each recorded new all-time highs.
- 2. Consumers are alive and well,** despite labor market softness, stubborn inflation and macroeconomic and geopolitical headwinds. Driven by persistent consumer spending, the U.S. economy expanded at its fastest pace in nearly two years, with second-quarter GDP revised to a 3.8% quarter-over-quarter increase.
- 3. Diversification shines:** The market’s impressive third-quarter performance was characterized by broadening participation, with small caps and international equities shining almost as brightly as gold.
 - a. Gold rally sets new records** as market uncertainty drove investors toward defensive assets. Gold’s performance in 2025 highlights its appeal as a hedge amid policy risks, inflation and a weakening dollar — [a triple threat](#).
 - b. International markets** continued to demonstrate strength, with developed and emerging market equities trailing U.S. stocks for the quarter. However, both still hold a more than 10% lead over the S&P 500 Total Return Index for the year.
 - c. Small-cap renaissance** was a significant shift, allowing small-cap stocks to stage a notable comeback. Alongside the rise of major indexes, the Russell 2000 notched a 9.3% gain and recorded its first record high close since November 2021, at 2,467.70 points — outperforming large-cap growth stocks. This resurgence coincides with [Morningstar’s reporting](#)¹ that small-cap growth, blend and value indexes emerged as the quarter’s top performers, indicating a pronounced shift in investor sentiment toward smaller enterprises. Small-cap stocks tend to perform better in low-interest-rate environments, which leads to the next point.
- 4. The Federal Reserve cut interest rates** by 25 basis points in September 2025, lowering the target range to 4.00%–4.25%. Widely anticipated by market participants, the shift toward a more accommodative monetary policy represents the beginning of a potential rate-cutting cycle, with the Fed signaling two additional quarter-point cuts before year-end. Fed Chair Jerome Powell emphasized that the softening labor market remains a priority, including that economic support takes precedence over inflation concerns.
- 5. Labor market conditions** are now a focal point for the Fed, which has shifted its monetary policy to address these concerns. The Fed’s recent rate cut underscores its commitment to supporting job growth amid challenging economic conditions, including corporate layoffs, talent shortages and restrictive immigration policies. However, the impacts of the latest U.S. government shutdown could introduce risks of delayed federal spending and disruptions in government services — potentially exacerbating current economic challenges and weakening consumer confidence.

Asset class performance | Q3 & YTD

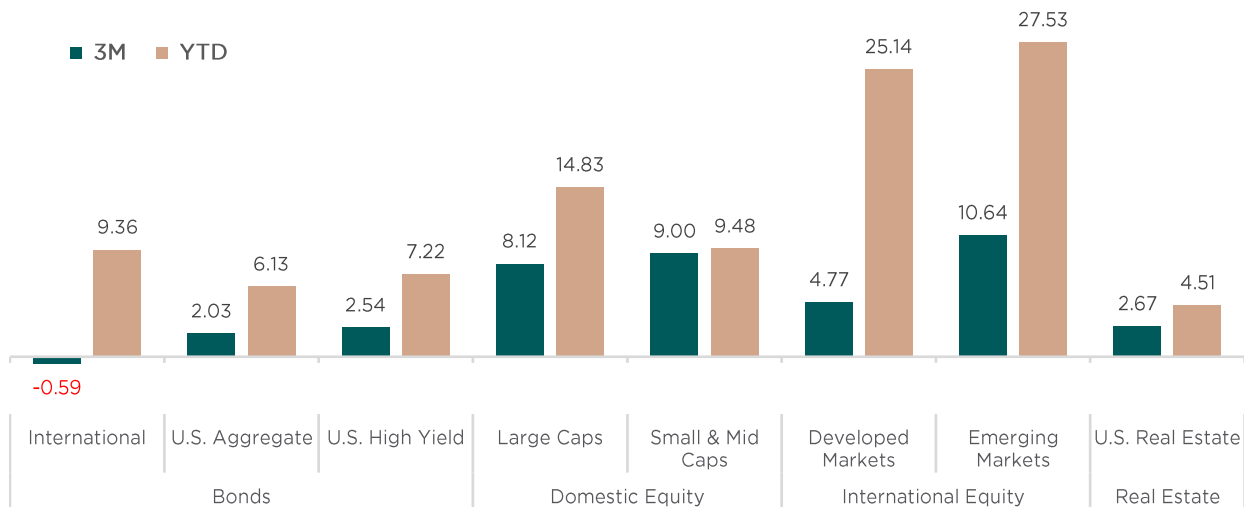
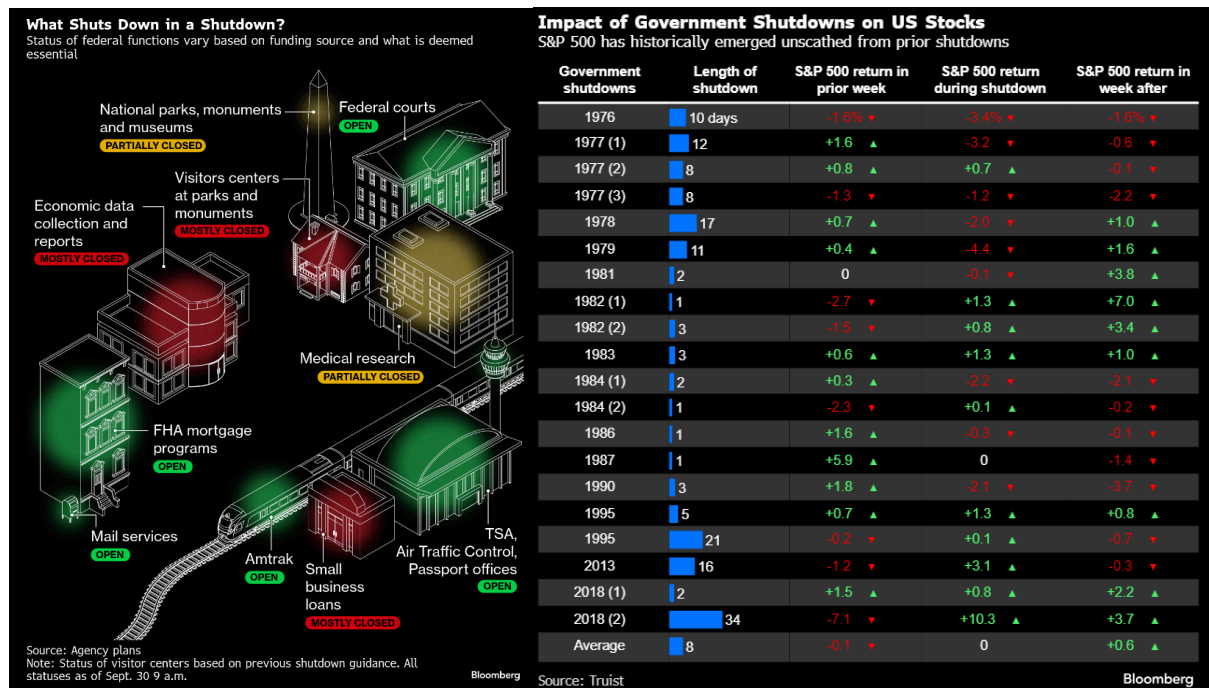


Chart of the quarter | S&P 500 has historically ignored shutdowns



Source: Bloomberg

As of midnight on Sept. 30, 2025, the U.S. government shut down after Congress failed to approve new spending for the fiscal year beginning Oct. 1. As non-essential agencies begin to shut their doors, the Congressional Budget Office estimates that approximately 750,000 federal employees will be furloughed, costing an estimated \$400 million per day in lost compensation. President Donald Trump has threatened to fire federal employees instead of furloughing them, a move that could trigger a surge in unemployment claims at a time the labor market is already fragile. This could increase volatility heading into the Fed's October meeting.

Historically, markets tend to be unfazed by government shutdowns. We believe that in the absence of data, the Fed should have little reason to deviate from its projected rate-cutting path.

Given the muted market reaction, investors are encouraged to [consult their advisors](#) before making any changes to investment allocations. A knee-jerk reaction today could have lasting consequences on their long-term goals and objectives.

FTWA outlook & implications

While 2025 has been a whirlwind, Fifth Third Wealth Advisors continues to subscribe to the mantra: "Don't fight the Fed." And while unexpected events will certainly occur — with several risks still present — we remain optimistic that the current bull market still has legs. Investor spirits are alive and well as they navigate through a global trade regime shift, policy risks, a slowing labor market, persistent inflation and stretched valuations.

Optimism:

1. **U.S. equities** may face stretched valuations. After contracting more than 20% and entering a tariff-induced bear market, then rebounding by over 34% through the third quarter, we now enter what is historically the strongest seasonal quarter for equity returns. The projected loosening of U.S. monetary policy — particularly in a non-recessionary environment — along with strong expected earnings and the pace and magnitude of planned share buybacks, give FTWA confidence in the extension of the bull market. While we remain optimistic about U.S. equities, stretched — albeit justified — valuations in large caps suggest that small- and mid-sized companies stand to benefit more from lower rates and higher projected earnings growth.
2. **International equities** have benefited this year from attractive valuations, deglobalization and a weakening U.S. dollar. While economic output may lag behind the U.S., we anticipate these trends to continue, especially with further trade pressure and U.S. monetary easing expected.
3. **Fixed income** is expected to continue offering attractive yield levels, particularly as concerns over the swelling fiscal deficit, tariff-induced inflation and stronger-than-expected growth may keep upward pressure on long-term bonds — even as short-term yields decline with Fed rate cuts.
4. **Alternatives** stand to benefit from several macroeconomic drivers and offer diversification benefits to portfolios. Commodities and precious metals, such as gold, can provide hedges against policy risk (i.e., government shutdown), a weaker U.S. dollar and inflation, whether tariff-induced or unexpected. With inflation expected to tick higher, other alternative assets such as real estate or infrastructure may also provide an inflation hedge, portfolio diversification and tax efficiency.

Risks:

1. **Non-transitory — or "temporary" — inflation** could send shockwaves through markets and trigger selling pressure. Given the forces at work, we view this as one of largest risks looming. Does the Fed have it wrong?
 - a. According to [J.P. Morgan Asset Management](#)², the average tariff rate now exceeds 19%. This raises several key questions: 1. Who will pay for the brunt of the levies? 2. Will it be a one-time price increase — essentially a tax? 3. Or will it result in ongoing price pressure?
 - b. **Monetary and fiscal policy** tend to lift prices. The Fed's rate cuts, combined with stimulus from the One Big Beautiful Bill Act, could lead to elevated inflation as rates decline and tax returns are filed in early 2026.
 - c. **Shelter costs** make up about one-third of the Consumer Price Index and have been among the largest contributors to inflation over the last few years. Due to supply-and-demand imbalances in the multifamily real estate market, we wouldn't be surprised if the current supply glut begins to apply upward pressure on rents — and subsequently lift shelter costs — starting in 2026 and beyond.
2. **Labor market deterioration** poses a risk to growth prospects and future monetary easing. Although unemployment claims remain relatively low, a surge in claims could prompt swift and aggressive action from the Fed — potentially sparking volatility.
3. **Policy risk:** Escalating conflicts in the Middle East, ongoing trade policy uncertainties with global partners, and changes to planned Fed actions remain notable risk factors for market volatility.
4. **Valuations and concentration risk** may lead to sharper market moves if volatility spikes. The concentration of the 10 largest stocks in the S&P 500 now represents a record-breaking 38.7% of the index. These stocks also carry extremely rich valuations of nearly 30x forward earnings, compared with the overall index trading at about 22%. High levels of concentration — especially paired with lofty valuations — make the index more susceptible to market volatility.

While we maintain a positive outlook for equities as we enter a historically strong quarter to close out 2025, considerable uncertainty remains. We believe maintaining adequate diversification is imperative as we navigate these conditions.

Thank you for your continued trust and confidence in us. Please [reach out to your advisory team](#) with any questions.

Sources:

1. Dan Culloton, "How Stock Funds Performed in Q3: Key Takeaways for Investors," Morningstar, 2025, <https://www.morningstar.com/funds/how-stock-funds-performed-q3-key-takeaways-investors>.
2. David Kelly, "Truth or Consequences: The Fed's Next Move," J.P. Morgan Asset Management, 2025, <https://www.linkedin.com/pulse/truth-consequences-feds-next-move-david-kelly-zblxe/?trackingId=vDNn9SjI9YUIRTmshNgkIq%3D%3D>

Definitions:

Barclays U.S. Aggregate Bond TR: Measures the performance of the total U.S. investment-grade bond market, including U.S. Treasuries, agency debt, mortgage-backed securities, asset-backed securities, and corporate bonds.

Barclays U.S. HY 2% Issuer-Capped TR: Tracks the performance of fixed rate dollar denominated debt securities. The debt instruments are non-investment grade. There's a limit of 2% maximum exposure to any one issuer.

Bloomberg Global Aggregate ex USD Total Return Index: Tracks the performance of investment-grade, fixed-rate bonds issued in currencies other than the U.S. dollar, including treasury, government-related, corporate, and securitized bonds from both developed and emerging markets.

FTSE NAREIT All Equity REITS TR: Measures the performance of U.S. publicly traded equity REITs, including both price changes and dividend income.

MSCI EAFE NR USD: Captures large and mid cap representation across 21 developed markets countries* around the world, excluding the U.S.

MSCI EM NR USD: Captures large and mid cap representation across 24 emerging markets countries.

Russell 2000 Index: Measures the performance of the bottom 2,000 stocks in the Russell 3000 Index.

Russell 2500 TR: Measures the performance of the smallest 2,500 companies in the Russell 3000 Index. This index is constructed to give a comprehensive and unbiased barometer for the small and mid-cap segment of the U.S. equity universe.

S&P 500 Total Return: Includes a representative sample of 500 leading companies in leading industries of the U.S. economy, calculated on a total return basis.

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International securities risks include fluctuations in the exchange rates of foreign currencies that may affect the U.S. dollar value of the investment, the possibility of substantial price volatility as a result of political and economic instability in the foreign country, less public information about issuers of securities, different securities regulation, different accounting, auditing and financial reporting standards and less liquidity than in the U.S. markets. Historically, these risks have tended to be more pronounced in emerging market countries than in more developed foreign countries.

Alts and non-traditional assets such as real estate, commodities, currencies and private companies, are subject to risks that are different from, and in some instances, greater than, other assets like stocks and bonds. Some non-traditional assets are less transparent and more sensitive to domestic and foreign political and economic conditions than more traditional investments. Non-traditional assets are also generally more difficult to value, and less liquid than traditional assets.

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Investing involves risks and you may incur a profit or a loss. Past performance does not guarantee future results

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