

QUARTERLY Market Rundown

Dan Phillips, CFA Chief Investment Officer

I Can See (More) Clearly Now

The third quarter was a good one for financial markets as investors received notable clarity on burning questions regarding the trade war, the job market and monetary policy. All our major equity asset classes moved higher – with U.S. small caps and emerging market equities showing pronounced gains (12.4% and 10.6% respectively) and U.S. large caps clawing back some year-to-date underperformance vs. their international developed counterparts (8% to 4.8% respectively). Meanwhile, interest rates fell modestly, credit spreads remain well-behaved and earnings growth accelerated – all offering fundamental support going into Q4.

*I can see clearly now, the rain is gone
I can see all obstacles in my way
Gone are the dark clouds that had me blind
It's gonna be a bright (bright) sunshiny day
-Johnny Nash (1972)*

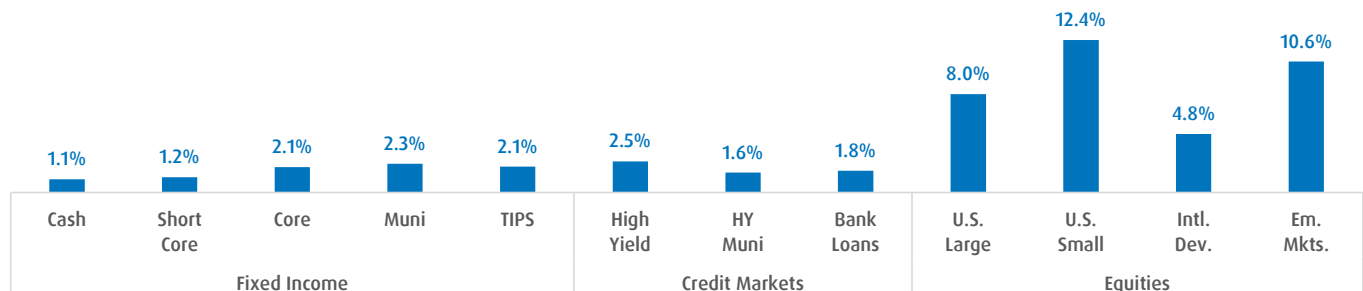
The start of Johnny Nash's 1972 hit song describes third-quarter markets quite well. Simply being able to "see (more) clearly now" the "obstacles" (i.e., risks) in the economy's way led to some rather "sunshiny" Q3 returns. Specifically, investors received greater clarity on three previously ambiguous risks: 1) tariff uncertainty – with recent negotiations providing a better sense of the trade-war end game; 2) labor-market data inconsistencies – where recent data revisions revealed the true (notably weaker) state of the job market; and 3) monetary-policy ambiguity – as the Federal Reserve (the Fed) finally cut rates and indicated greater focus on the labor market side of its maximum employment/price stability dual mandate. The three risks still remain, but investors now have a better ability to price the risks by having more clarity on what the specific risks actually are – namely: 1) the economic impact ~15% tariffs will have on the economy; 2) the signal sent by the weak jobs market – falling economic demand or simply greater productivity?; and 3) the rate cuts necessary to satisfy the Fed's full-employment co-mandate.

We contemplate these key risks (see following page) in the context of an otherwise-constructive fundamental backdrop. Economic growth continues (3.8% in Q2¹ – the latest actual data we have) and further growth expected in Q3 (2-4% per the various Fed regional bank² "nowcasts"). Inflation, while still above the Fed's 2% target, has been stable at just under 3%. Finally, corporate earnings have been remarkably resilient, showing strong growth (S&P 500 Q2 actual year-over-year growth of 9.7% and Q3 estimated year-over-year growth of 12.8%³). Perhaps the only "dark cloud" heading into Q4 are elevated equity valuations – particularly on the S&P 500, which ended the quarter at 27.7x⁴ trailing 12-month earnings (creeping higher from the 26.5x starting the year and well above the 22.0x 10-year average). But that dark cloud may lack much "rain" as expectations for continued earnings growth strength supports the higher valuations, which are a poor market-timing indicator anyway.

We do see two other potential clouds forming – renewed geopolitical risks around Russia given President Donald Trump's recent about face (now seemingly fully on Ukraine's side) and an extended government shutdown. The former could cause market volatility, but it won't last unless it impacts fundamentals via higher oil prices (and the world is currently well supplied); the latter is unlikely to cause much economic disruption – though could delay key economic data releases.

A strong performance – with equities stealing the show

The third quarter of 2025 brought positive returns to all major asset classes, including double-digit returns for long-struggling U.S. small caps.



Source: Bloomberg L.P. Returns from 6/30/2025 to 9/30/2025. See index definitions and disclosures for additional information.

¹ Bloomberg L.P. ² Federal Reserve Bank of New York, Federal Reserve Bank of Atlanta, Federal Reserve Bank of St. Louis. ³ S&P Global. ⁴ Bloomberg L.P.

Macro Key Developments

Tariff Resolutions

Markets were dazed (and confused) by the April 2 Liberation Day “reciprocal” tariffs announcement, which included a 20% tariff on the European Union and even a 10% tariff on the Heard and McDonald Islands (mostly penguin-inhabited with no U.S. imports to tariff). The nonsensical tariff rates created (by design?) broad uncertainty on the trade war’s conclusion. Most of that uncertainty has been resolved, with top trading partners generally agreeing to tariffs around half the original threat (Exhibit 1). And while agreements are still pending with the big-three U.S. trading partners, most Canadian and Mexican imports are (for now) covered by still-in-place free-trade agreements and U.S.-China discussions have been more cordial than feared.

The tariffs have not yet had a meaningful impact on inflation. But the tariff pressures will gradually rise as pre-tariff inventory stockpiling needs replacements and still-open trade talks reach agreements. This, it has been noted, will prolong the tariff concern – but it will also buy companies time to maintain prices with cost-offsetting solutions.

Jobless Expansion

Unfortunately, one of the above cost-offsetting solutions is labor rationalization, especially when new technologies are primed for deployment. This may be contributing to the recent job-creation malaise – just 107,000 jobs created in the past four months, well below what’s theoretically necessary to replace labor-force exits (e.g., retirements) and employ new entrants (e.g., college grads). Markets also learned that the most recent annual payroll revision wiped out 911,000 jobs, the largest downward revision on record and the second consecutive year of notable job overestimation (Exhibit 2).

While raising questions over preliminary-data usefulness, the corrected numbers offered increased clarity to the markets – and, more importantly, the Fed – on the state of the labor market (see below). Interestingly, the labor market’s “state” is less concerning than the poor job creation suggests. Low jobless claims imply employers aren’t firing, even if they aren’t hiring. Technology may be “taking” newly added jobs, but not existing jobs, keeping unemployment low.

Fed Reengaged

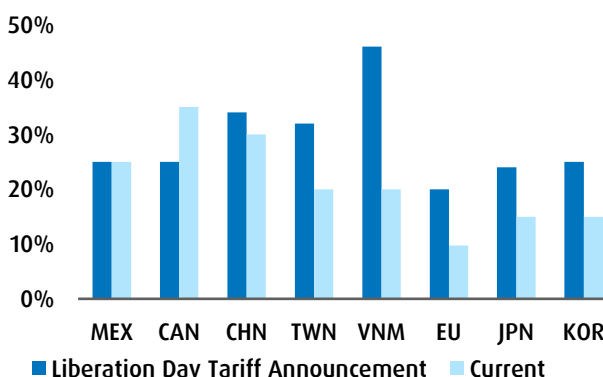
Payroll frugality may improve productivity, but stagnating job growth is unsustainable. Economies need demand – and neither AI nor robots go shopping. The Fed well realizes this necessity and recently started its latest rate-cutting cycle with a 0.25% rate cut. In doing so, the Fed not only removed rate-cut-start-date uncertainty but also confirmed its current primary focus has shifted to its full employment co-mandate, with its price stability co-mandate deemphasized for now.

The biggest rate-cut rebuttal is inflation’s stubborn stall out at ~1% above the 2% Fed target. But the price stability co-mandate does not dictate an inflation level. The Fed volunteered the 2% inflation target; it could technically move that target – so long as inflation remains “stable” at that new target level. This would uproot precedent – but could, nevertheless, provide potential cover for the majority of the committee projecting cuts at the last two 2025 Fed meetings (Exhibit 3). Political influence is clearly in play as recent Trump Fed appointee, Stephen Miran, calls for five more cuts this year.

Exhibit 1: Negotiated settlements

Tariffs ended up lower; Mexico/Canada/China negotiations ongoing.

US Tariffs

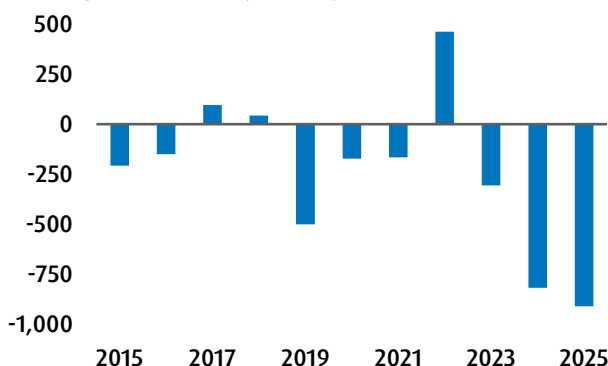


Source: U.S. Customs and Border Protection (CBP), Congress.Gov; As of March 2025; MEX = Mexico*, CAN = Canada*, CHN = China, TWN = Taiwan, VNM = Vietnam, EU = Eurozone, JPN = Japan, KOR = South Korea. *USMCA-compliant goods

Exhibit 2: Increasing inaccuracies

The past two years saw major revisions to employment numbers.

U.S. Payroll Revisions (in 000's)

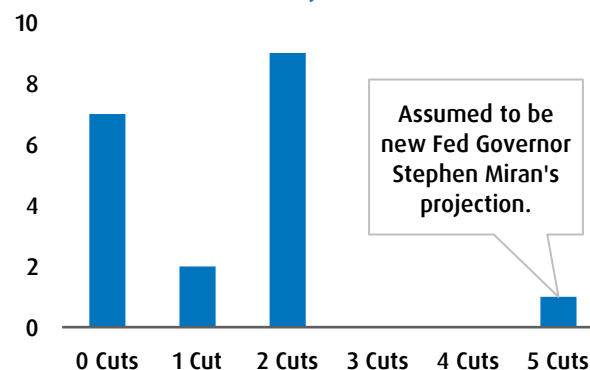


Source: Bloomberg L.P. Most recent revision released 9/9/2025.

Exhibit 3: Gravitational pull?

New Fed governor Stephen Miran is a strong voice for more cuts.

Fed Member End-of-Year Projections



Source: Bloomberg L.P. Projections from September 17, 2025, Fed release.

Market Review

Fixed Income

The start of the Fed rate-cutting campaign pushed the (Fed-controlled) front end of the yield curve lower quarter-to-quarter, as the (primarily market-driven) longer end of the yield curve barely budged – just an ever-so-slight move lower (Exhibit 4). But the small quarter-to-quarter interest rate movement masks some economic-expectation shifts beneath. The modest move lower in the 10-year yield overcame a more noticeable move higher (0.1%) in 10-year inflation expectations, perhaps indicating market support for the theory that the Fed may “tolerate” above-2% inflation, despite a continued pledge of allegiance to its 2% target. Meanwhile, the 30-year yield coming back below 5% is a reassuring sign as to the market’s assessment of Fed credibility.

At the index level, higher duration meant higher returns – consistent with a modest “bull steepener” (where the yield curve steepens because the front end comes down more than the back end, leading to positive returns across the yield curve). Meanwhile, broad municipals offered similar/slightly higher returns versus their taxable counterparts.

Credit Markets

High-yield aggregate credit spreads continued to tighten – ending Q3 at 2.66% – and are now within spitting distance of their pre-Liberation Day low of 2.56%. The quarterly drop in high-yield aggregate spreads equalled 0.24% – as compared to drops of 0.05%, 0.20% and 0.67% across the BB, B and CCC credit-quality buckets, respectively. Notably, while BB-rate spreads are now at post-global financial crisis lows, CCC-rate spreads remain a good 1.5% above their personal best – their current 10%+ all-in yield looking attractive should economic growth and inflation remain at current levels (higher inflation makes debt repayment easier so long as the issuing company has pricing power).

At the index level, high-yield aggregate returns equaled 2.5%, with CCC-rated bonds offering a 4.2% return. Meanwhile, (tax-exempt) high-yield municipals returned 1.6% and (generally floating-rate) bank loans returned 1.8%. All said, well-behaved high-yield credit spreads and solid returns from the lower-quality credits is creating a constructive financing environment as we head into the last quarter of the year.

Equities

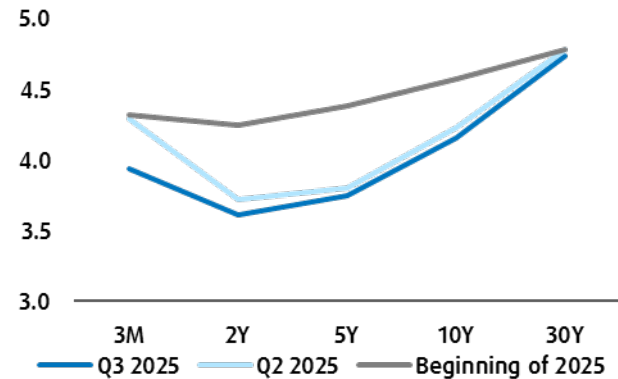
Broad global equities (as proxied by the MSCI All Country World index) returned an impressive 7.6% for the quarter, comprised of regional returns of 8.1%, 4.9% and 10.6% across the U.S., international developed and emerging market MSCI indices, respectively. The U.S. outperformance over international developed (3.3%) was helped by 1% in currency appreciation as the dollar began to recoup some of its earlier-year (supposed “death of American exceptionalism”) losses. Within the U.S., small cap outpaced large cap by 4.4% (12.4% versus 8%) – as it became clear the Fed would start cutting rates (rate cuts benefit small caps more given greater use of short-duration debt).

In addition to greater clarity on the key risks discussed on the prior page, equity markets – notably U.S. equities – benefited from higher valuations and strong Q2 earnings (released mostly in the first half of the third quarter). S&P 500 companies beat top-line revenue and bottom-line earnings expectations by 2.1% and 7.6%, respectively – implying greater-than-expected margin expansion despite inflation.

Exhibit 4: Widening yield curve belly

The “belly” of the yield curve is dipping as rate cuts are priced in.

Yield Curve - United States

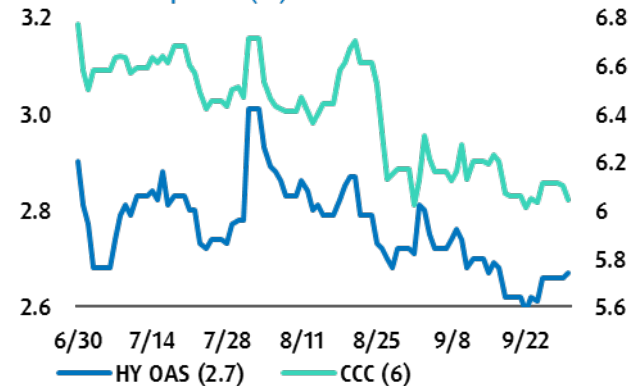


Source: Bloomberg L.P.

Exhibit 5: Good credit spreads!

Credit spreads remain well-behaved, continuing to move lower.

Select Credit Spreads (%)

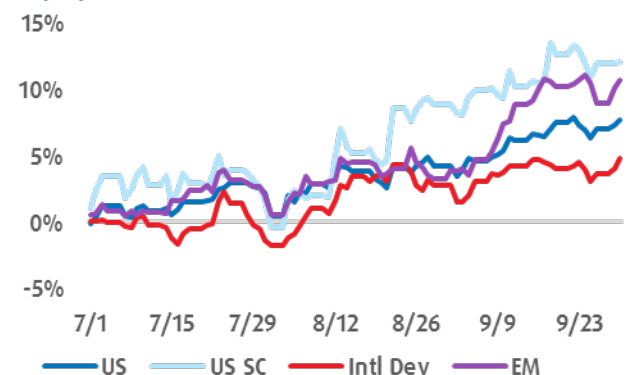


Source: Bloomberg L.P. Daily data from 6/30/2025 to 9/30/2025. HY = High Yield; OAS = Option-Adjusted Spreads

Exhibit 6: The momentum continues

Equity markets continue their upward march post-Liberation Day.

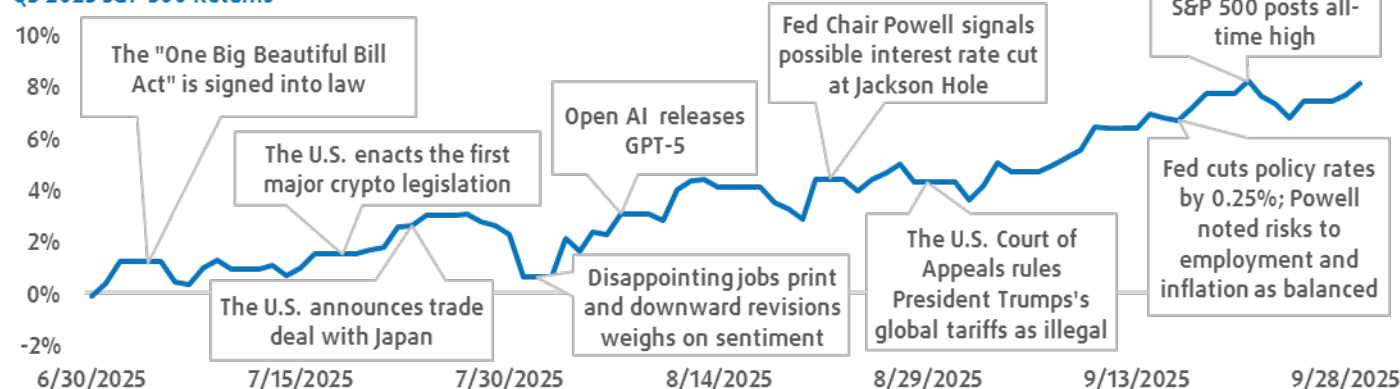
Equity Market Returns



Source: Bloomberg L.P. Daily data from 6/30/2025 to 9/30/2025.

Exhibit 7: Third Quarter Timeline

Q3 2025 S&P 500 Returns



Index Definitions

Cash: Bloomberg US Treasury Bill: 1-3 Months Index tracks the market for treasury bills with 1 to 2.9999 months to maturity issued by the US government. **Short Core:** The Bloomberg Short-Term U.S. Aggregate Bond Index specifically tracks bonds with remaining effective maturities between one and five years. **Core Muni:** Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market. **TIPS:** The Bloomberg US Treasury Inflation-Linked Bond Index (Series-L) measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. **High Yield:** Bloomberg U.S. Corporate High Yield Index measures the U.S.D-denominated, high yield, fixed-rate corporate bond markets. **High Yield Muni:** Bloomberg Muni High Yield Index is an unmanaged index that measures the returns of high yield, fixed rate municipal bond markets. **Bank Loans:** S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market based upon market weightings, spreads and interest payment. **US Large Cap:** Russell 1000® Index consists of the largest 1000 companies in the Russell 3000 index. **US Small Cap:** Russell 2000® Index (Russell 2000®) is an unmanaged index of large-cap common stocks. **MSCI ACWI** captures large and mid cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. **The MSCI USA Index** measures the performance of large and mid-cap segments of the U.S. equity market. Data provided above is as of 9/30/2025 unless separately noted.

Disclosure

"BMO Wealth Management" is a brand delivering investment management services, trust, deposit and loan products and services through BMO Bank N.A., a national bank with trust powers; family office services and investment advisory services through BMO Family Office, LLC, an SEC-registered investment adviser; investment advisory services through Stoker Ostler Wealth Advisors, Inc., an SEC-registered investment adviser; and trust and investment management services through BMO Delaware Trust Company, a Delaware limited purpose trust company. These entities are all affiliates and owned by BMO Financial Corp., a wholly owned subsidiary of the Bank of Montreal. BMO Delaware Trust Company operates only in Delaware, does not offer depository, financing or other banking products, and is not FDIC insured. Not all products and services are available in every state and/or location. Family Office Services are not fiduciary services and are not subject to the Investment Advisers Act of 1940 or the rules promulgated thereunder. Investment products and services are: **NOT A DEPOSIT – NOT INSURED BY THE FDIC OR ANY FEDERAL GOVERNMENT AGENCY – NOT GUARANTEED BY ANY BANK – MAY LOSE VALUE.** Capital Advisory Services are offered by a division of BMO Bank N.A.

This report is not a client-specific suitability analysis or recommendation, to buy, sell, or hold any security. Do not use this report as the sole basis for your investment decisions. Do not select an asset class, investment product, or investment manager based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon.

This report and any discussions of specific securities, fund managers, or investment strategies are for informational purposes only and are not investment advice. This report does not predict or guarantee the future performance of any security, fund manager, market sector, or the markets generally.

This report contains our opinion as of the date of the report. We will not update this report or advise you if there is any change in this report or our opinion. We do not represent or warrant that this report or our opinions are accurate or complete. This report and our opinions are based on numerous sources believed to be reliable. It is not guaranteed for accuracy but provided for informational purposes only.

Forward-looking statements in this report involve risks, uncertainties and other factors that may cause actual performance to differ materially from the projections and opinions contained in the report. Do not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of the report. Forward-looking statements are not guarantees of future performance or events. Forward-looking statements involve risks and uncertainties about general economic factors. It is possible that predictions, projections and other forward-looking statements will not be achieved.

Investment involves risk. Market conditions and trends will fluctuate. Investment returns fluctuate, and investments when redeemed, may be worth more or less than the original investment. Asset allocation and diversification do not guarantee a profit and do not eliminate the risk of experiencing investment losses. Past performance is not indicative of future results.

The index data shown is used for informational and comparative purposes. You cannot invest directly in an index. Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced.

This report is not legal or tax advice. We do not provide legal advice to clients. You should review your particular circumstances with your independent legal and tax advisors.

Our affiliates may provide oral or written statements that contradict this report.

You may not copy this report or distribute or disclose the information contained in the report to any third party, except with our express written consent or as required by law or any regulatory authority.

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.