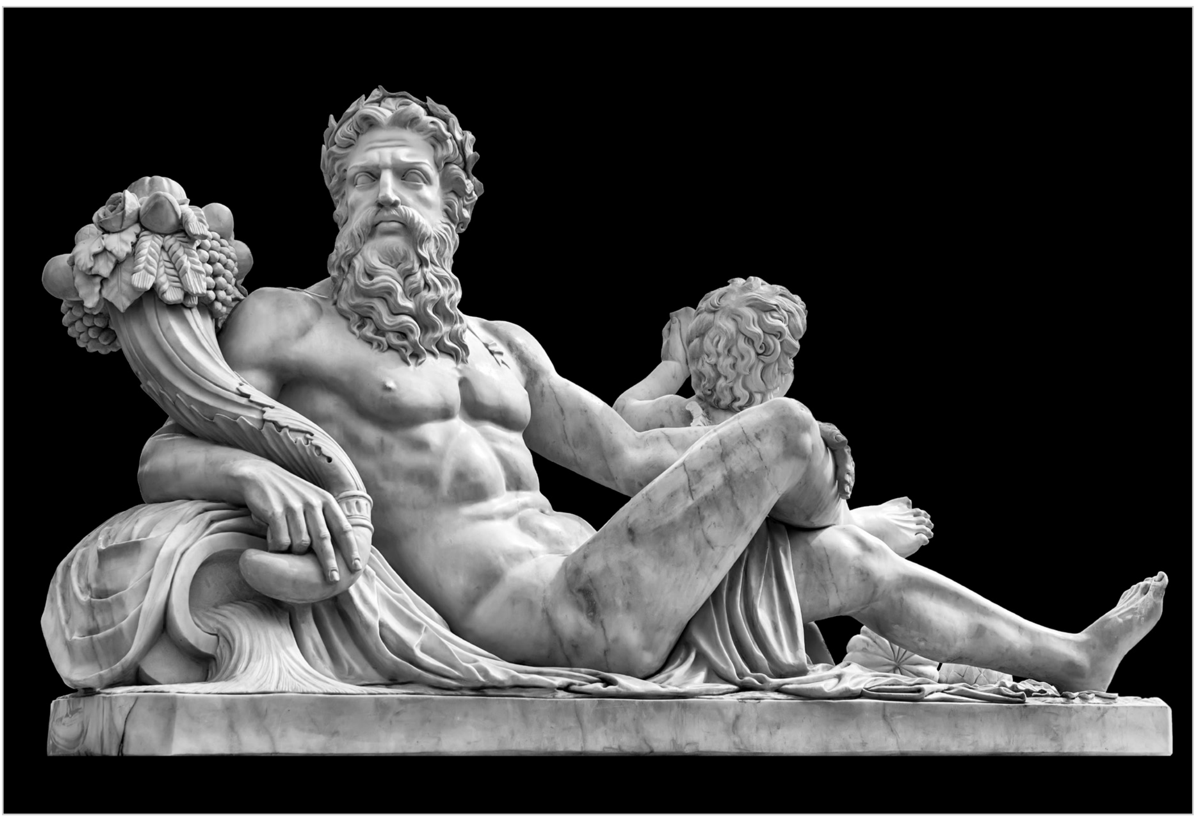
INVESTMENT OUTLOOK
A PEAPACK PRIVATE PUBLICATION

THIRD QUARTER 2025: CORNUCOPIA, OR AN EMBARRASSMENT OF RICHES

Too much of a good thing can be wonderful.
—Mae West

A cornucopia is, according to Merriam-Webster, a curved, hollow goat's horn or similarly shaped receptacle that is overflowing, especially with fruit and vegetables. Today, it is used as a decorative motif emblematic of abundance. The word cornucopia is derived from Latin: 'cornu' meaning horn and 'copia' meaning plenty—hence, horn of plenty.

The cornucopia dates back to the 5th century BC. In Greek mythology, Zeus was sheltered in a cave, where he was watched over by a goat named Amalthea. As Amalthea was nursing Zeus, he accidentally pulled off her horn. The remorseful Zeus promised that the horn would always bring her what she wanted and, from then on, it has represented endless bounty.



To this day, the cornucopia remains a potent symbol of abundance, prosperity, and the harvest.

Our contemporary cornucopia has, arguably, roots in modern day mythology—in the belief that the masters of economic policy can guide the economy through a period of extended and widespread prosperity. Financial markets today are benefiting from a remarkable era of plenty: plenty of policy support, plenty of liquidity, plenty of animal spirits. No need, apparently, for investors to contemplate Shakespeare's question, "Why then, can one desire too much of a good thing?"

ENDLESS BOUNTY: MARKETS FLOURISH

For unto whomsoever much is given, of him shall much be required.
—Luke 12:48

Much was given to investors in the third quarter. All that was required was to be invested. Returns across all markets were so robust in the third quarter that one could say they are a testament to the power of myths. All asset classes delivered positive returns for the third quarter. Emerging markets led the performance parade, and previously lagging smaller US companies also generated strong gains.

Asset Class	Index	3rd Quarter Returns	Year to Date Returns
US Large Cap Stocks	S&P 500 Total Return	8.1%	14.8%
US Large Cap Stocks	S&P 500 Equal Weighted	4.8%	9.9%
US Small-Mid Cap Stocks	Russell 2500	9.0%	9.5%
International Developed Markets Stocks	MSCI EAFE	4.8%	25.1%
Emerging Markets Stocks	MSCI EM	10.6%	27.5%
Real Estate Securities	MSCI US REIT	4.8%	4.7%
Commodities	Bloomberg Commodities Futures	3.7%	9.4%
Bonds	Bloomberg Barclays US Aggregate	2.0%	6.1%
Cash	FTSE USBIG 1-Month Treasury Bill	1.1%	3.3%

SOURCES: THE WALL STREET JOURNAL, STANDARDANDPOORS.COM, FTSE, MSCI, BLOOMBERG

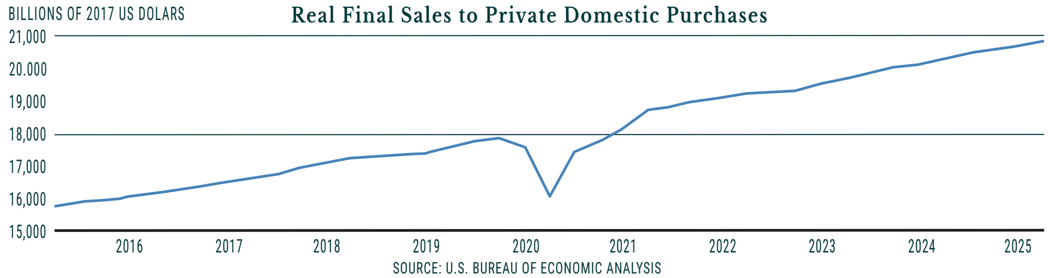
For the year to date, US large cap stocks' returns are in double digits—if these results hold, they will constitute the third consecutive year of double digit returns. That said, the stand-out asset classes for US investors this year have been international stocks, both developed and emerging markets, with gains almost double those of the S&P 500. Real estate securities have lagged, but made progress in the third quarter as interest rates declined. Bond returns have also been solid.

It's worth noting that the trend of megacap technology companies' out-performance is showing persistence, as can be seen from the healthy but lesser returns of the S&P 500 equal weighted index. With this benchmark, each stock comprises 0.2% of the index. In the standard capitalization (cap) weighted S&P 500 benchmark, the ten biggest companies (Nvidia, Microsoft, Apple, Alphabet, and so on) constitute a whopping 38% of the index, whereas they constitute only 2% of the equal weight benchmark. The stronger performance of the cap weighted index is attributable to large gains recorded by the biggest, fast growing technology companies.

ECONOMIC ACTORS GIVE A BRAVURA PERFORMANCE

Weeping may remain for a night, but rejoicing comes in the morning.
Psalm 30:5

After a rocky first quarter that saw GDP shrink by 0.5%, the US economy came roaring back with a 3.8% advance in the second quarter. These figures, however, reflect distortions driven by wildly fluctuating imports—imports soared in the first quarter, as companies strove to bring in goods prior to the imposition of increased tariffs. In turn, imports dropped substantially in the second quarter. Set aside this volatile component and the economy appears to be fairly sound. Real final sales to private domestic purchasers—which incorporates both consumer spending and gross private fixed investment—rose by 2.9%, a meaningful improvement from the first quarter's 1.9% rise.



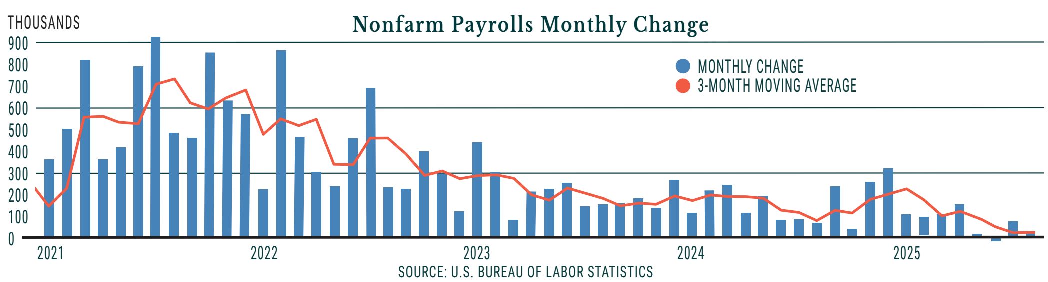
As the chart above indicates, real final sales have risen steadily over the past ten years, through all kinds of political and economic conditions, with the notable exception of the Covid era.

The US economy's sound performance is particularly notable during a quarter in which there was much gnashing of teeth as businesses and consumers were thrown off balance by an ever-changing series of tariff levies and announcements.

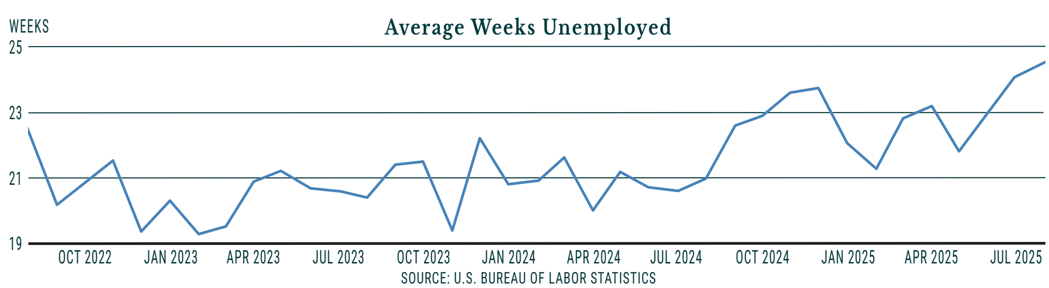
That economic momentum appears to have carried through the just-ended third quarter. The latest estimate from the Atlanta Federal Reserve Bank for the quarter, its GDPNow data point, stands at a robust 3.9%.

It is more than a little curious that economic strength is manifest when perhaps the two most important elements of the US economy, the labor market and inflation, both show signs of stress.

There is clear evidence of deceleration in the labor market. Although new unemployment claims—an indicator of company lay-offs—remain at quite muted levels and the unemployment rate of 4.3% is historically low, new job creation has slowed dramatically.

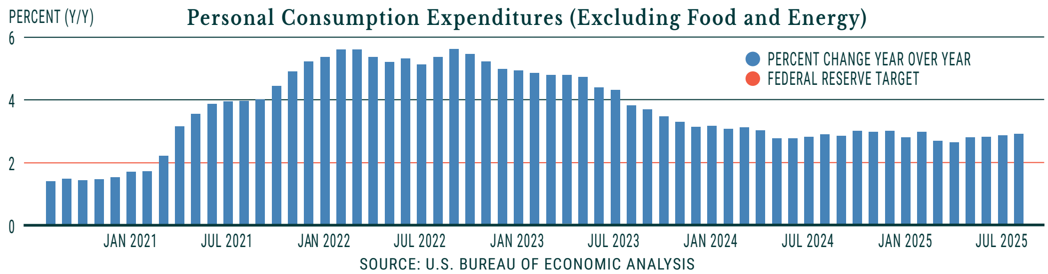


As the chart above indicates, the US job creation machine has gone on pause. In August, the US generated a mere 22,000 net new jobs. Other indications as well of a softer labor market include fewer job openings/unfilled jobs and an increasingly length of time for unemployed workers to become re-employed.



As the graph above shows, average weeks unemployed have risen from a trough of 19.5 weeks in February 2023 to 24.5 weeks recently.

Even as labor demand has softened, prices continue to rise. Using the Fed's preferred measure of inflation, core Personal Consumption Expenditures (PCE), inflation rose 2.9% over the past 12 months, significantly higher than its 2% target. The last time core PCE was at target was March 2021.



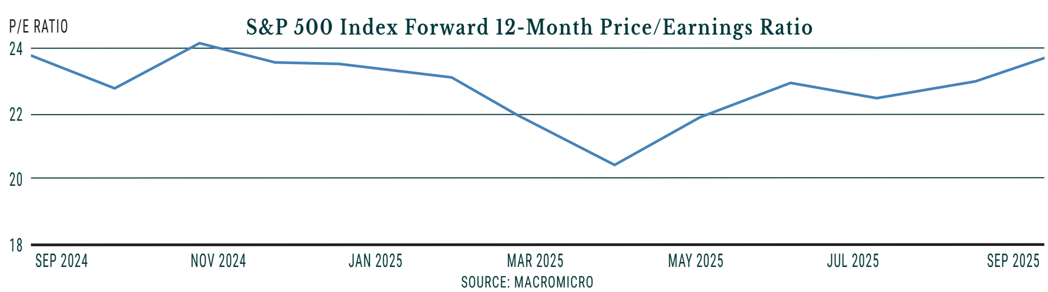
The Federal Open Market Committee is clearly challenged currently to meet its dual mandates of full employment and price stability—even as the economic expansion continues.

MARKETS: FLYING HIGH, OR HIGH, FLYING?

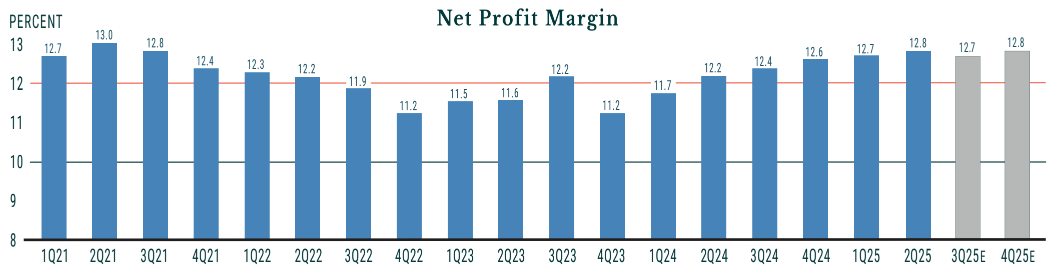
Now is the winter of our discontent
Made glorious summer by this sun of [New] York
—Shakespeare

How quickly markets shook off the Trump tariff blues of early April, recovering losses and then scaling new heights throughout the long languid days of summer. There are a plethora of indications of a return of animal spirits for investors. The number of Initial Public Offerings (IPOs) pricing so far this year is up 61% compared with this point in 2024, according to Renaissance Capital. Merger and acquisition deal volumes are up 30% this year over 2024, according to Dealogic. Private equity deal value is also up 30% year to date versus last year. Meme stocks—shares that experience large price changes as a result of dedicated online followers—are also back in vogue.

Even as public markets rallied with investors re-embracing risk-taking, valuations—although elevated—did not become significantly more expensive. This is because buoyant corporate profits have been the primary driver of market action—versus investors' willingness to pay ever more for each dollar of corporate profits. FactSet reports that in the second quarter S&P 500 companies grew earnings by 12% over the prior year. Revenues rose by 6.4%. As the chart below indicates, the forward price/earnings ratio has been fairly constant between 22 and 24 times for most of the past year, even as the S&P 500 rose briskly over this time frame.



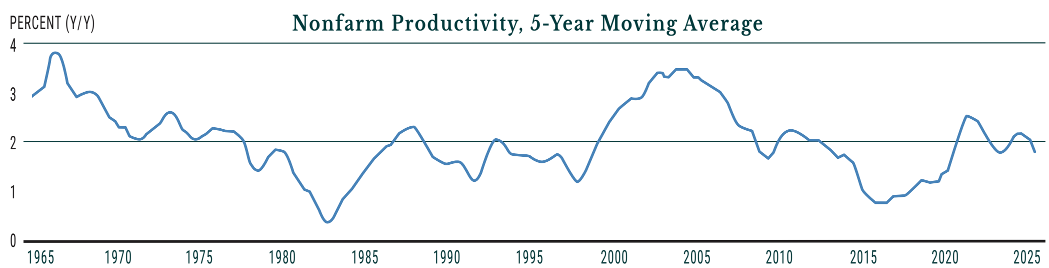
Net profit margins held up well, clocking in at 12.8%—the fifth consecutive quarter that S&P 500 margins exceeded 12%. Furthermore, analysts anticipate margins to remain wide in the balance of the year and into 2026.



SOURCE: FACTSET

This is a remarkable result in the face of inflation pressures, generally, and with regard to tariff effects, specifically. Several factors may be supporting elevated margins, including inventory purchases made in advance of prospective tariffs, cost controls, and some absorption of tariffs by exporters.

Perhaps the most intriguing potential contributor to margins may be productivity improvements. Productivity is a measure of efficiency—how well a company utilizes resources to deliver goods and services. Economists focus on productivity as it promotes faster growth and restrains inflation. It also enhances profitability.



SOURCE: CHARLES SCHWAB, BLOOMBERG

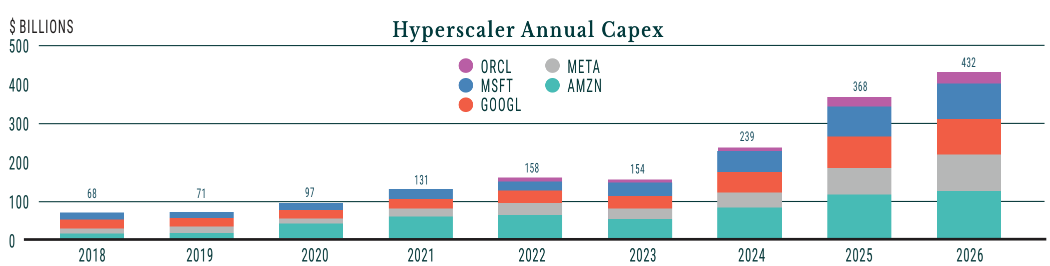
The chart above reflects the variability of US productivity growth, including a long steep decline in the late 1960s and 1970s (a period of high inflation, oil embargoes, and severe recessions) and a significant improvement in the late 1990s and early 2000s (driven, notably, by the widespread adoption and utilization of the Internet).

Artificial intelligence (AI) enthusiasts believe we are on the cusp of another such paradigmatic shift upward in productivity—that AI will transform the economy and reshape the nature of work.

THE AI REVOLUTION

No matter how much cats fight, there always seem to be plenty of kittens.
—Abraham Lincoln

Call it a catfight, call it an arms race, call it a feeding frenzy, call it FOMO. Even as the rewards and financial returns from AI may be uncertain, the scale of capital investment in AI is real, and unprecedented.



SOURCE: GOLDMAN SACHS

Hyperscalers' capital expenditure growth has been booming, soaring 75% in 2025. The leading US technology companies are each spending tens of billions of dollars to purchase graphics processing units (GPUs)—the cutting edge semiconductor chips that power AI—and to develop and run advanced AI models.

Such a growth rate, however, is ultimately unsustainable, and capex growth is projected to fall below 15% by midyear 2026. That's still a huge commitment of capital. While the payoff of such enormous investments is highly uncertain, there is significant potential for a dramatic leap forward in productivity, and enormous rewards for early movers in what may prove to be a 'winner take most' environment.

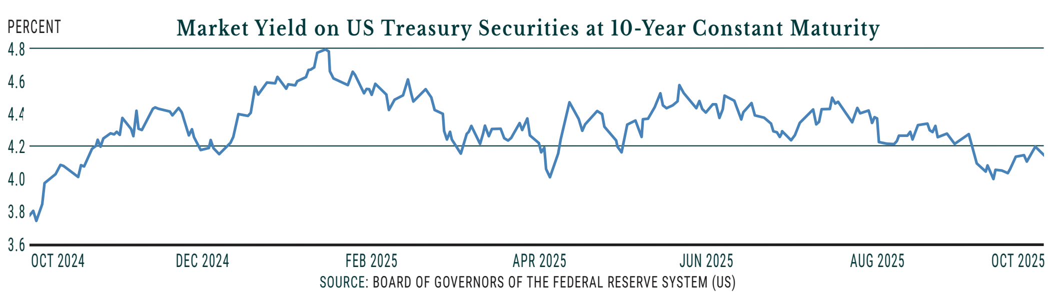
POLICY PERSPECTIVE: FLOODING THE ZONE

More, more, more
How do you like it? How do you like it?
More, more, more
How do you like it? How do you like it?
—Gregg Diamond

As noted, healthy economic growth and rapidly growing corporate profits are two persuasive drivers propelling stock prices higher. But wait, as they say on late night infomercials, there's more. Unquestionably, investor enthusiasm has been stoked by perhaps the most constructive policy backdrop in decades.

From a fiscal policy perspective, the backdrop could scarcely be more favorable. While it may be poor long-term economic policy, running sizable deficits is stimulative for the economy. Post-pandemic federal government deficits for the past three (post-Covid) fiscal years, as a percentage of GDP, have been 5.3%, 6.1%, and 6.3%. For the just completed fiscal year of 2025, it is estimated at 6.2%, and the fiscal 2026 estimate is for a 5.6% deficit.

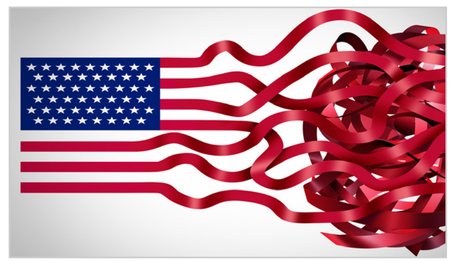
The recently enacted OBBBA legislation provides further economic stimulus. Corporate tax benefits include 100% bonus depreciation (the ability to immediately deduct the cost of capital expenditures for equipment and machinery), immediate expensing of research and development costs, and business interest deductions, among others. In total, businesses are projected to see their taxes lowered by $1.2 trillion over 10 years. Tax breaks for individuals include no taxes on tips, overtime, and Social Security payments (subject to some limitations); higher state and local tax deductions; and higher standard deduction. These tax cuts are projected to reduce individual taxes by $1.5 trillion over 10 years. (Note that spending cuts from the tax bill—which constitute tighter monetary policy—don't kick in until 2027 and 2029.)



Monetary policy joined the stimulus party in September, when the Federal Open Market Committee (FOMC) cut its Fed funds rate by one quarter of a percentage point and signaled two additional rate cuts by year end. Lower rates stimulate the economy directly, by lowering interest expenses, and indirectly by creating a lower threshold for returns on investment projects. In addition, the Fed is poised to end quantitative tightening, its policy of reducing its balance sheet by letting its assets mature without reinvesting them. (Quantitative tightening has the effect of draining liquidity from the economy, putting upward pressure on interest rates.)

Further policy support comes in the form of the second Trump administration's sweeping deregulatory agenda. Among the changes that have been initiated:

- Environment: ending reporting of industrial emissions, rolling back clean air and water rules, and loosening auto emissions standards
- Healthcare: shortening enrollment periods and eliminating some tax credits, rescinding Medicare cap on out-of-pocket drug costs
- Transportation: rescinding airline passenger protections
- Financial Markets: pausing SEC rulemaking and rolling back climate-related and ESG disclosure requirements, reducing bank capital requirements
- Creation of the Department of Government Efficiency (DOGE).



The effect of these regulatory rollbacks is to reduce companies' compliance and monitoring costs, thus boosting profits. Proponents of deregulation believe businesses will invest more and hire more in a less regulated environment.

Trade policy, which has dominated the business news for much of the last six months, continues to follow a somewhat erratic path, but the uncertainty around tariffs has diminished notably. The announcement of trade deals or agreements in principle suggests that the overall tariff rate will come in at approximately 14%—a substantial rise from prior levels but well below initial indications. Resolution of tariff and trade issues is constructive for businesses as they formulate their investment and hiring plans.

THE PARADOX OF PLENTY

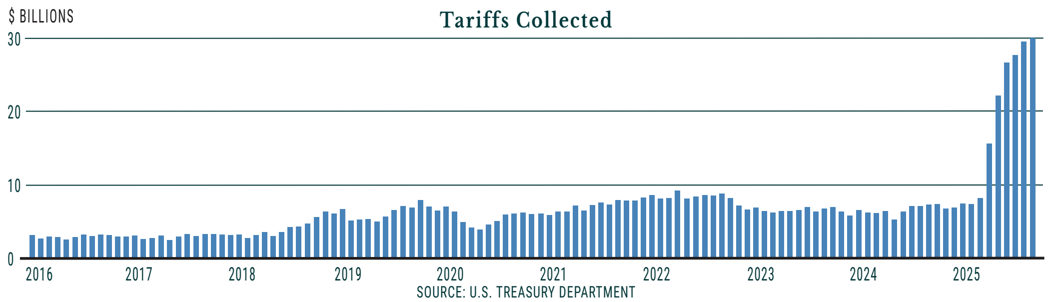
We are stripped bare by the curse of plenty.
—Winston Churchill

Corporate profits are growing smartly. The policy backdrop for financial markets is highly favorable. The AI revolution narrative is persuasive to most market participants. Volatility is low. Liquidity is high. Momentum is positive. Seasonality favors the fourth quarter. There's good news a-plenty to support investor enthusiasm.

It is tempting to discount so much good news—to say it's priced into the market already, or it's inevitable that one or more elements of the narrative turns down, or that an exogenous shock will upset the apple cart. Stocks' progress may not be linear, but it's hard to argue that there isn't a compelling case to be made for further equity appreciation over the next year.

What are the main risks to the feel-good story? Labor market deterioration, inflation, and geopolitics.

The first two of these risks are tariff-related risks. On the labor market front, if companies are unable to pass along the cost of tariffs, they may resort to implementing reductions in force to protect profit margins. Fed Chair Powell has characterized the labor market environment as "low hire, low fire." While demand for labor has clearly softened, so has supply—an aging population and sharply reduced immigration have resulted in little or no growth this year in the US total labor force size. This dynamic could render businesses reluctant to trim their workforces, especially if economic growth persists.



On the inflation front, there are two concerns. One is the aforementioned tariff issue. Tariff receipts have been rising—the Customs and Border Protection agency collected tariffs totaling $31 billion in both August and September. (For context, monthly tariff revenues averaged less than $7 billion in 2023 and 2024.)

There is limited evidence thus far of any impact of tariffs on consumer prices. Further, most economists believe that tariffs are a one-time price adjustment, and do not contribute to ongoing, persistent inflation. (We'll refrain from commenting on the accuracy of economists' beliefs.) It remains to be seen whether companies absorb the cost of tariffs, or whether there has simply been a lag between the imposition of tariffs and a pass-through to end consumers.

The stimulative monetary and fiscal policy initiatives, as noted, could well accelerate economic growth and contribute to a greater inflation impulse.

It always feels safe to note geopolitical risks to an economic outlook—regrettably, there are always some hotspots around the world that could lead to economic turmoil. What's noteworthy now for this standard risk is the fracturing of alliances. Deglobalization has given rise to unilateralism, fragmentation of the global order, transactional diplomacy, and ideological divergences could result in heightened mistrust, greater risk of confrontations, and unexpected and disjointed responses to geopolitical events. Investors simply need to live with this risk—it is not readily mitigatable.

ABUNDANCE, OR EXCESS?

Moderation is a fatal thing. Nothing succeeds like excess.
—Oscar Wilde

Substantial opportunities amidst substantial risks—a challenging environment for portfolio positioning. Then again, it's always a challenging environment for portfolio positioning.

Notwithstanding elevated valuations, US large cap stocks warrant maintaining exposure. Bespoke Investment Group noted that AI-related stocks have accounted for 75% of S&P 500 returns, 80% of earnings growth, and 90% of capital spending growth since ChatGPT launched in November 2022. To be sure, it's a concentrated market, which carries inherent risk. But the AI capital investment story hasn't run its course, even if it is no longer novel. Prodigious hyperscaler cash flows and business tax cut provisions should help sustain the narrative. Perhaps most importantly, analysts have been revising upward forward profit estimates, in the face of steady consumer spending and rising capital expenditures.

That said, relative valuations for US small cap stocks are striking. By some measures, the valuation gap versus US large cap stocks is the widest it has been since the 1990s. Small cap stocks are more sensitive to interest rates, more cyclical in nature, bigger beneficiaries of lower interest rates, and more domestically focused—thus, beneficiaries of the policy set-up. After a long stretch of under-performance, small cap stocks may be poised to lead the charge.

International stocks may be poised to continue their out-performance versus US stocks. There is a similarly persuasive relative valuation argument to be made—international stocks trade at a 34% discount to US stocks, versus an historical average discount of 19%. Overseas stocks also tend to perform well for US investors when the US dollar is weak, which has been the case for 2025 and may well continue into 2026.

Real estate, too, is riding favorable tailwinds. Lower interest rates, back-to-office policies, and healthy retail sales are supporting higher occupancy levels and rents for the sector.

On the fixed income front, the likely direction of interest rates is down. The FOMC has shifted its focus to its full employment mandate, and is poised to cut rates further. Changes in the composition of the committee next year will likely increase the presence of inflation 'doves' who will push for lower interest rates. In such an environment, we favor extending duration—that is, purchasing bonds with somewhat longer maturities to take advantage of comparatively higher current rates. And a focus on higher quality seems appropriate in a more speculative investment environment.

One year from now, the US will hold midterm elections. Incumbent parties historically lose a lot of seats in midterm elections—the average over the past 22 midterm elections is a loss of 28 House seats and 4 Senate seats. No wonder all administrations do their utmost to juice the economy early in their terms so voters feel optimistic when they go to the polls. The Trump Administration is no exception. As outlined, it has primed the economic pump with bountiful dollops of fiscal and monetary stimulus and with legislative victories on popular issues. With its policy initiatives, the Administration has pushed through a bold pro-growth agenda.

It's an ambitious agenda. There is a nontrivial risk that it succeeds all too well, that the economy becomes over-stimulated, that it grows faster than potential, that it results in increased leverage, and that it drives inflation higher. In short, that we experience a second Roaring Twenties. Alas, we remember how the first one ended.

Which recalls another Greek myth, illustrating what happens when abundance becomes excess, becomes over-consumption. The unfortunate Erysichthon angered Demeter with his disrespect for nature, and was cursed with insatiable hunger. This caused him to consume his kingdom and, eventually, himself. An important reminder to push back from the table when we have had our fill.

In heady times, investors do well to understand their risk tolerance even as they party on.

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