
 INVESTMENT UPDATE

Q3: Upward and Onward

Following the carnage of early April and the momentous bounce back to end the first half, a breather would have been understandable for Q3. No such “breather” was taken by Mr. Market, however. The third quarter saw a further continuation of the AI-led rally, combining AI “everything” with a healthy dose of upside gains from anticipated Fed rate cuts and fiscal spending overseas.



With only 3 months remaining, the skeptic and the pessimist have each been left to reconcile the harsh reality that the markets can rally into a myriad of headwinds. In fact, the markets have priced-in optimism that has pushed both tech titans and even some blue-chip stocks to levels not seen in decades. Did you realize Costco trades at a higher P/E than NVDA?

Below is a recap of performance for key risk assets for the first half of 2025:

S&P 500	+14.8%	MSCI EAFE	+25.1%
Russell 2000	+10.4%	Bitcoin ETF	+22.5%
Nasdaq	+17.9%	Gold ETF	+46.8%

In anticipation of a Fed ready to accelerate the pace of its rate-cutting cycle, fixed income saw yields press lower across the short end of the curve. Gold continues to post its most robust gains in decades with no sign of slowing.

NOT CHEAP...But Does it Matter?

Often cited as a reason to move dollars around within the markets, **valuation has historically proven to be a poor tool for timing markets.** Rather than a mechanism for timing, we believe valuation should be viewed as the foundation upon which a proper asset allocation of stocks and bonds is laid.

Valuation can offer insights into what may be realistic and unrealistic expectations looking ahead 3-5 years. Valuation can offer clues as to how much potential risk should be rewarded.

Investing is both an art and a science. Seldom have we seen the masses rushing to buy an asset class, trend or theme and subsequently proven to be right. Instead, the disciplined, patient, and contrarian are more often the long-term winners. Charles Merrill (co-founder of Merrill Lynch), Warren Buffett, and Sir John Templeton headline an elite list of investors who believed one must not follow the masses off the proverbial cliff.

We are not market timers! We are situationally aware, however. When valuations of segments of a market become extended (as we see in some pockets of growth today) it is prudent to do a few basic things to manage risk: right-size/pair back allocations, consider hedging strategies or stop loss orders (for stocks or ETFs), or replace a portion of such allocations with risk-managed strategies in the same “style box (i.e. Large Cap Growth).”



On the flip side of trimming or de-risking positions viewed as fully valued or outright overpriced, one can also revisit adding to assets that may remain inexpensive. Before doing so, one should acknowledge that some such assets are inexpensive for a reason. Some are bad businesses, segments of the market facing huge headwinds, or markets unlikely to gather support from the masses any time soon. Without dollars flowing toward an asset class, it seldom pushes meaningfully higher.

All of this brings us to today, as we enter the “final turn” of 2025.

- What’s expensive?
- What’s justifiable and what’s not?
- What’s cheap? What’s attractive?
- What has a catalyst and is likely to garner more investment flows?

On a recent call, we were reminded of the enormous scale of the AI spend by the “hyper-scalers.” Furthermore, the energy needs and ultimate sources and timing of revenue scaling remain uncertain. Does that mean one should forego exposure to AI and AI-related companies? Of course not. Should one be judicious in the scale of allocations to such segments of the market? We believe it is prudent to have that conversation. Many of these names have enjoyed tremendous stock price appreciation in 2025 (all in anticipation of a well-executed and unending AI rollout).

As the chart below illustrates, while elevated P/E ratios may not provide precise 1-year expectations, they do offer solid directional guidance over a 5-year window. The takeaway: elevated P/E ratios typically lead to below average 5-year outcomes. Could it be different this time? Perhaps. Does this portend a cataclysmic market selloff? Not necessarily.

P/E ratios and equity returns

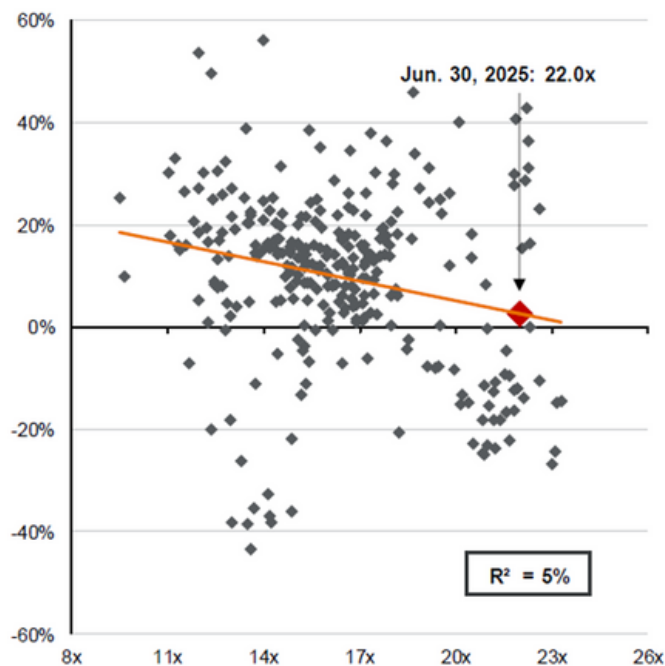
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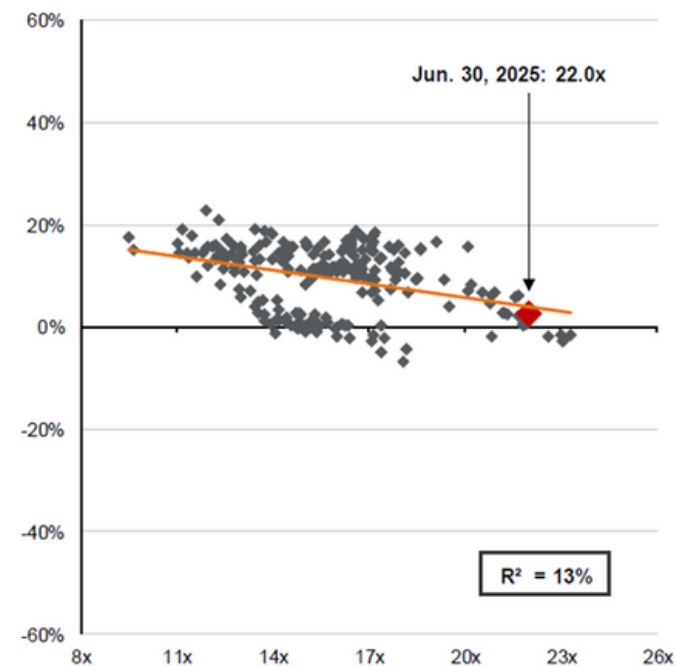
Forward P/E and subsequent 1-yr. returns

S&P 500 Total Return Index



Forward P/E and subsequent 5-yr. annualized returns

S&P 500 Total Return Index



Source: FactSet, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management.
Returns are 12-month and 60-month annualized total returns, measured monthly, beginning 5/31/1999. R^2 represents the percent of total variation in total return that can be explained by forward P/E ratios. The forward P/E ratio is the most recent S&P 500 Index price divided by consensus analyst estimates for earnings in the next 12 months, provided by IBES since May 1999 and FactSet since January 2022.
Guide to the Markets – U.S. Data are as of June 30, 2025.



Our takeaway from the current landscape marked by historically elevated P/E levels is to maintain a disciplined balance of risks utilizing every available tool that can help mitigate risk effectively. We have also been “nibbling” at some of the lower-priced segments of the market. Owning less of the segments that seem priced to perfection leaves one less vulnerable to an outsized correction while lower P/E assets can perform well in a sluggish economy. You can achieve this differentiation / diversification while still owning a mix of great global businesses.

But I SWEAR this must be a BUBBLE...

Every time (at least in the last 25 years) we look upon a market that is “expensive” there are pundits who cleverly draw parallels to the late 1990’s that ended in the Technology Bubble. This is probably the most overplayed narrative of our careers.

Less than two weeks ago Fed Chair Powell proclaimed that equity markets are “fairly highly valued.” What does that even mean? Selling stocks? Questionable at best. Be patient? Perhaps. I ran out of ways to capture headlines so I thought this might work...sounds reasonable. Powell is a businessman whose track record at the Fed is not widely regarded as amazing. Why would one take his investment advice (if, in fact, that was even his intent)?

The next “bubble” will undoubtedly look much different than the last (the Global Financial Crisis) or the one prior (the Tech Bubble) yet some cannot let go of the idea of trying to predict the next one. So, let’s revisit the Tech Bubble that came upon us 25 years ago. Who “called” it?

Arguably, the most famous predictor of the Tech Bubble was Fed Reserve Chairman Alan Greenspan. It was his December 1996 speech on Irrational Exuberance that is still the most referenced evidence of “I told you so.”



What too often goes unsaid, to quote the late great Paul Harvey, is “the rest of the story.” **While Greenspan did sound the alarms, it was about as timely as Paul Revere riding through town in 1774. From the day of Greenspan’s speech to the peak of the Nasdaq in March 2000, the index rose an astounding 298%.**

Was Greenspan misleading us? No. Was he ultimately correct? Yes. Was his timing precise? Hardly. And therein lies the reason we don’t base our investment decisions on forecasts. Markets can and often will behave irrationally. How else does one explain the V-shaped recovery in the Spring of 2020 or April of this year. Markets are ALWAYS looking forward, anticipating and pricing in what they view as lying around the next turn. There are very few “original thoughts” as an investor on Wall Street.





Rather than reading volumes to predict the next Black Swan event, we feel it most appropriate to focus on managing risk (interest rate, credit, thematic, market, timing, etc.) so that we give ourselves the best opportunity in any environment. The tools available to mitigate risk today are more robust and liquid than ever before and it is through use of those instruments we remain confident that we can remain invested in a risk-appropriate way through most any conditions that may come our way.



Extreme was more than a 1990's Rock Band

- Known best for their 1990 hit "More than Words", Extreme was quite the successful rock band. In the world of investing, extremes seldom end well for investors. Below are a few memorable examples:
- The Roaring Twenties (with over 500% market appreciation) ended with the Crash of 1929 and subsequent Great Depression
- The 1987 Crash (-22% in a single day) led to massive regulatory and liquidity changes for markets (but 1987 finished up just over 5%)
- The nearly 600% runup of the Nasdaq from 1995-2000 sparked a fierce 2 ½ year selloff that ended the euphoria for many profitless companies and over-levered investors
- The 2008 Global Financial Crisis was rooted in lack of risk management across US mortgage industry then morphed into something far larger.

In each of these instances, there were ways to make money. In the 1920's, Merrill famously exited the markets before the Crash and became a household name after redeploying capital in the years that followed. That's the extreme outlier. In 1987, the best bet was to have done nothing. Aside from a modest loss in 1990, a patient investor saw the Dow appreciate 6-fold in the next 12 years.

While the Tech Bubble punished speculative stocks in the late 1990's, global strategies and value investors like Warren Buffett fared well. Berkshire Hathaway posted gains of 28.6% and 7.3% in '00 & '01. Evillard's First Eagle Global posted gains each of the 3 years from 2000-02. Among the bests investments to own in 2008 was the US Treasury.





Each of the above are unique and the solutions best suited for successfully navigating them were likewise varied. In each of these eras, excess is easy to see in hindsight but far less visible to the masses in real-time. Are we set up for a repeat today? Today's valuations in portions of the market concern us, but we don't yet see the broad excesses we saw with past bubbles. Extreme... perhaps not. Elevated and worth watching? Absolutely! ***The one consistent feature that will never go out of style for our clients: risk-management. We cannot predict the future, but we can prepare for it.***

When you come to a fork in the road take it...

This Yogi Berra saying is perhaps one of his most profound. Earlier in the newsletter we referred to having more tools than ever to combat the uncertainties that face today's investors. Rather than determining **whether** to own US or non-US stocks, Mag 7 over the rest of the market, or **whether** to allocate more to small caps, we feel it more useful to focus on **HOW** to own them.

What do we mean by HOW?

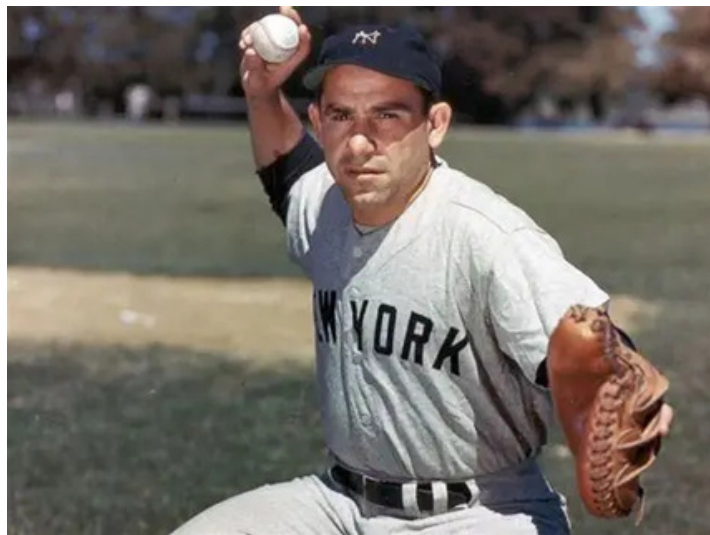
As an example, one can own large cap US Growth in seemingly innumerable ways. Traditionally an investor would either select individual stocks or hire an ETF or Mutual Funds manager to invest in Large Cap Growth for them. Today, there are additional ways to "change the game", from covered call strategies that combine an income focus with stocks, to buffered ETFs that offer downside risk mitigation.

So, which is right for you?

The tool depends on the task at hand. A good chef may own 10 knives or a carpenter 5 hammers because each serves a different purpose. So too does each investment tool. Buffered ETFs can offer protection against a "normal" market correction while Covered Call strategies historically excel in a volatile/sideways environment. If the coast appears all clear, "long only" offers the most upside.

Fortunately, **it is our job** to determine the correct tool for the task at hand. We aren't asking you to prepare your own meal but rather offering a small insight into what goes on in the kitchen. A lot of advisors speak about risk management, but we truly work exhaustively to integrate it into every decision we make. As Yogi quipped, "In theory there is no difference between theory and practice. In practice there is. "and "If you don't know where you are going, you might wind up someplace else."

Yogi was a wise man and a heck of a baseball player!





The Federal Reserve often speaks of its dual mandate: Price stability and maximum employment. Our dual mandate is to be disciplined enough to capture market upside (even when it may not feel good) while maintaining the appropriate focus on risk mitigation. We always strive for excellence but aim to look most differentiated when the waters are most choppy. As we have said many times, seldom is our mandate to make clients wealthy. Rather, we are most often charged helping you stay wealthy.

Fear not, I'm here from the government and...

The media has insisted that the markets will be rattled by the impending government shutdown, but the chart below suggests the impact of such a move will likely matter very little. The last 20 shutdowns since 1976 have an average impact of 0% on equities and 0.03% on US Treasuries. The US government matters to markets over time but much less for a season. Shutdowns are generally regarded as a political tool that few want to be used, yet one markets tend to ignore.

Market action around federal government shutdowns							
Shutdown Start	# of Days	S&P 500 returns			10-year U.S. Treasury moves		
		Week prior	During	Week after	Week prior	During	Week after
09/30/76	10	-1.6%	-3.4%	-1.6%	0.01%	-0.20%	-0.04%
09/30/77	12	1.6%	-3.2%	-0.6%	0.02%	0.13%	0.00%
10/31/77	8	0.8%	0.7%	-0.1%	0.06%	-0.02%	-0.05%
11/30/77	8	-1.3%	-1.2%	-2.2%	0.03%	0.08%	0.04%
09/30/78	17	0.7%	-2.0%	1.0%	0.00%	0.06%	0.03%
09/30/79	11	0.4%	-4.4%	1.6%	0.17%	0.64%	0.53%
11/20/81	2	0.0%	-0.1%	3.8%	-0.04%	0.30%	-0.31%
09/30/82	1	-2.7%	1.3%	7.0%	-0.21%	-0.22%	-0.68%
12/17/82	3	-1.5%	0.8%	3.4%	-0.02%	-0.10%	-0.11%
11/10/83	3	0.6%	1.3%	1.0%	-0.12%	0.07%	-0.08%
09/30/84	2	0.3%	-2.2%	-2.1%	-0.02%	0.05%	-0.24%
10/03/84	1	-2.3%	0.1%	-0.2%	0.18%	-0.22%	-0.08%
10/16/86	1	1.6%	-0.3%	-0.1%	0.20%	0.03%	-0.08%
12/18/87	1	5.9%	0.0%	-1.4%	-0.44%	0.05%	0.01%
10/05/90	3	1.8%	-2.1%	-3.7%	-0.15%	0.17%	-0.06%
11/13/95	5	0.7%	1.3%	0.8%	0.00%	-0.03%	-0.05%
12/15/95	21	-0.2%	0.1%	-0.7%	0.04%	-0.09%	0.06%
09/30/13	16	-1.2%	3.1%	-0.3%	-0.09%	-0.02%	-0.07%
01/19/18	2	1.5%	0.8%	2.2%	0.11%	-0.01%	0.04%
12/21/18	34	-7.1%	10.3%	3.7%	-0.10%	-0.03%	-0.07%
Average	8	-0.1%	0.0%	0.6%	-0.02%	0.03%	-0.06%
Positive %		60%	50%	45%	45%	50%	30%

Data sources: Truist IAG, FactSet, Bloomberg, U.S. House of Representative.
Past performance does not guarantee future results.

We consider it an honor to serve you and would be grateful for your introduction to other likeminded families.

2280 Valley Vista Road, Knoxville, TN 37932
865-999-5332