

On Our Radar – October 2025

The S&P 500 Index advanced 3.5 percent in September, supported by the Federal Reserve's decision to cut interest rates and a surge in capital spending on artificial intelligence (AI) data centers. These investments helped lift corporate earnings among many large-cap technology firms, which led the market higher. Meanwhile, the yield on the 10-year U.S. Treasury Note declined to 4.16 percent from 4.23 percent at the end of August, and oil prices slipped roughly 2 percent to about \$62.50 per barrel.

The standout performer for the month and year-to-date - was gold. The yellow metal rallied 12.6 percent in September, climbing to a record high well above \$3,800 an ounce. Strong central bank demand, coupled with investors' efforts to diversify their portfolios, drove much of the move. Gold's ascent accelerated after the U.S. froze Russian foreign assets, prompting countries to turn to gold as a hedge against a weaker dollar, geopolitical tensions, and unpredictable trade policies. Additionally, rising U.S. debt levels and the Trump administration's preference for a softer dollar have altered global demand dynamics. Some central banks have even begun cutting rates despite persistent inflation, as governments seek to spend their way out of mounting debt burdens.

TJT Capital Group's InVEST Risk Model® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

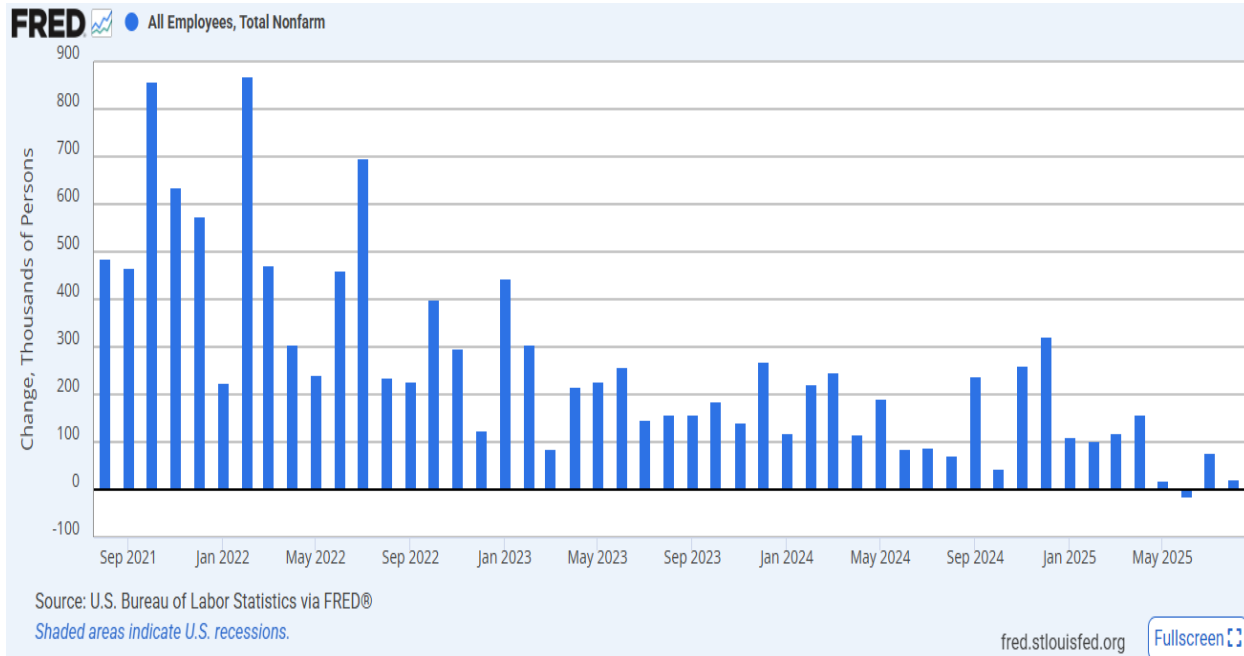
On September 17, 2025, the Federal Open Market Committee (FOMC) voted to lower the federal funds rate by 25 basis points (0.25%), setting a new target range of 4.00 to 4.25 percent.

The decision reflected growing concern over labor market softness that has now taken precedence over inflation risks. The Fed's preferred inflation measure, Core Personal Consumption Expenditures (Core PCE), rose 2.9 percent year-over-year, remaining above the 2 percent target. Fed Chair Jerome Powell characterized the move as a "risk management cut," intended to provide additional support amid signs of slowing growth.

Powell noted that job creation has weakened considerably, with monthly payroll gains averaging only 29,000 over the summer. Benchmark revisions reduced total employment by 911,000, underscoring the labor market's vulnerability. Reflecting these trends, the Fed now projects the unemployment rate will reach 4.5 percent by year-end. The central bank's latest economic forecasts call for modest growth, with median projections of 1.6 percent for 2025 and 1.8 percent for 2026.



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Federal debt now stands at nearly 119 percent of Gross Domestic Product (GDP), compared to an average of around 103 percent before the COVID era, as shown in the accompanying chart. Since then, policymakers appear convinced that the solution to excessive borrowing is more borrowing. The U.S. alone must refinance approximately \$9 trillion in debt by March 2026.



Over the past year, yields on longer-term government securities have climbed, reflecting this growing concern. For example, when the Fed cut rates by half a percentage point in September, the yield on the 10-year Treasury actually rose 46 basis points to 4.16 percent. Deficit spending is also pushing global yields higher: in Germany, the U.K., and Japan, 10-year government

bond yields have increased 59, 70, and 79 basis points, respectively, as investors demand greater compensation for swelling fiscal deficits.

Valuation

Earnings estimates for the S&P 500 are currently projected at approximately \$258 for 2025 and \$303 for 2026. Because the equity market is inherently forward-looking, this places the price-to-earnings (P/E) ratio on 2026 earnings at about 22 times.

Focusing on a shorter horizon, earnings over the next four quarters are estimated at roughly \$281, implying a P/E ratio of around 23.6 times. Historically, such levels suggest that valuations are stretched. When valuations move meaningfully above their long-term averages, the risk/reward balance becomes less favorable, as the potential for upside diminishes relative to the downside risk should things change.

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Economic Cycle

Turning to the U.S. economy, second-quarter GDP growth was revised up to an annualized rate of 3.8 percent, half a percentage point higher than the prior estimate. The upward revision reflected a decline in imports, which was driven by tariff policies, and an increase in consumer spending. However, August employment data showed signs of slowing momentum as non-farm payrolls rose by just 22,000, while the unemployment rate edged up to 4.3 percent.

Retail sales in August increased 0.6 percent, industrial production ticked up 0.1 percent, and new home sales surged more than 20 percent as mortgage rates eased. Yet, not all indicators were encouraging. The Conference Board's Leading Economic Index (LEI) fell 0.5 percent in August, while consumer sentiment declined to 55.1 from 58.2 and consumer confidence slipped to 94.2 from 97.4. One clear takeaway is that recent tariff policies are creating unintended ripple effects across the economy.

A case in point is that the U.S. recently pledged a significant economic aid package to Argentina in support of President Javier Milei. In response, Argentina lifted export tariffs on several key agricultural products shipped to China. Beijing, facing steep 20 percent retaliatory tariffs on U.S. soybeans, quickly shifted its purchases to Argentina. As a result, American farmers have made no soybean sales to China this year and may ultimately require a government bailout to offset

the losses. This is another example of the collateral damage from the ongoing U.S.-China trade conflict.

Sentiment

Bullish sentiment has remained in the mid-50 percent range over the past couple of months, while bearish sentiment has fallen by roughly half since early May. Because sentiment typically tracks the market's recent trend, these readings are not unusual. However, as complacency builds, the market may become more vulnerable to sharp reactions from unexpected developments—particularly as we approach year-end, when hedge funds begin adjusting their positioning.

Technical Factors

Over the past month, approximately 59 percent of stocks have traded above their 50-day moving average. The advance/decline line has been solid, but the current uptrend needs to persist, as much of the good news may already be priced in.

In an environment marked by high equity ownership, steady fund inflows, elevated valuations, and a degree of investor complacency, any weakening in technical indicators could serve as an early warning sign that market momentum is beginning to fade.

Outlook

As October 1, 2025, the U.S. government has entered a shutdown following Congress's failure to reach a budget agreement.

The strong rally in equities has driven market valuations to elevated levels. While overvaluation alone does not end a bull market, it does suggest that investors have less margin for error should an unexpected event occur.

The greatest risks to markets are often those being overlooked. If a risk were obvious, investors could take steps to hedge against it. One timeless lesson concerns excessive lending to borrowers with limited ability to repay—an issue at the heart of the 2008 subprime mortgage crisis. In recent years, a newer area of finance—private credit—has expanded rapidly as traditional banks pulled back from lending. Assets under management in the sector have more than quadrupled over the past decade, reaching approximately \$1.5 trillion.

Recent reports suggest some private credit firms have begun accepting “payment-in-kind” (PIK) securities in lieu of cash interest payments. In practice, this means that borrowers unable to meet interest obligations are adding them to the principal owed and deferring the cash outlay. While PIK arrangements can provide short-term flexibility, widespread usage often signals financial stress. Notably, PIK issuance has roughly doubled from its historical average, and many publicly traded private credit firms have seen their stock prices decline by more than 20 percent from their 2025 highs—an early warning sign worth monitoring.

Equity markets have been buoyed by a combination of modest economic growth, lower interest rates, and resilient corporate earnings. Still, valuations remain rich: S&P 500 stocks are trading near three times sales, well above historical norms. A key driver of recent earnings growth has been a surge in capital spending on artificial intelligence, which has increased roughly sixfold since 2020 to about \$364 billion. Should AI-related investment continue to expand as projected, current valuations may prove sustainable.

However, elevated valuations also leave markets vulnerable to repricing in the event of negative surprises. An extended government shutdown, for example, could weigh on sentiment. Geopolitical uncertainty also looms, particularly following President Trump's recent remarks suggesting Ukraine should reclaim all lost territory—a notable shift from earlier calls for a swift resolution to the conflict.

Some market indices have also shown signs of weakness. Since late November 2024, the Dow Jones Industrial Average has gained roughly 3.7 percent, while the Dow Jones Transportation Average has declined about 12 percent. Historically, such divergences—particularly when sustained over time—have often preceded periods of softer market performance. As a result, investors should remain vigilant, as the range of potential outcomes could be wider than usual. (10.6.25)

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