Tame Inflation, Strong Earnings, and a Fed Cutting Cycle. Will Equities Rally into Year-End?

OREGON PACIFIC WEALTH MANAGEMENT
A Registered Investment Advisor

Exhibit 1: Trailing Returns as of October 31, 2025

	Index/ETF	1-Mo	3-Mo	YTD	1-Y	3-Y	5-Y
Equities	US Growth (SPYG)	3.4%	9.8%	23.5%	32.0%	28.4%	18.3%
Equities	US Large-Caps (SPY)	2.4%	8.2%	17.4%	21.4%	22.5%	17.5%
Equities	International Developed Equities (SPDW)	1.7%	9.0%	29.7%	25.8%	20.2%	12.3%
Equities	Broad-based Emerging Markets (SPEM)	1.6%	10.6%	25.6%	21.8%	19.8%	8.2%
Equities	US Value (SPYV)	1.2%	6.5%	10.9%	9.4%	15.7%	16.0%
Equities	US Mid-Caps (SPMD)	-0.5%	3.4%	5.2%	6.4%	11.8%	13.0%
Equities	US Small-Caps (SPSM)	-0.9%	7.3%	3.5%	5.5%	8.2%	12.1%
US Fixed Income	Municipal Bonds (MUB)	1.2%	4.3%	3.3%	3.6%	4.9%	1.1%
US Fixed Income	US Treasury 7-10 Year (IEF)	0.7%	3.0%	7.8%	6.4%	4.3%	-1.8%
US Fixed Income	US Aggregate Bond Index (SPAB)	0.7%	3.0%	6.9%	6.3%	5.6%	-0.2%
US Fixed Income	Treasury Inflation Protected Notes (SPIP)	0.4%	2.5%	7.3%	5.9%	4.5%	1.4%
US Fixed Income	Investment Grade Corporate Bonds (SPBO)	0.2%	2.9%	7.3%	6.8%	7.8%	0.6%
US Fixed Income	High Yield Credit (JNK)	-0.1%	2.2%	7.2%	8.1%	9.7%	4.6%
Commodities	Silver (SLV)	3.9%	32.1%	67.1%	47.7%	35.7%	14.9%
Commodities	Gold (GLD)	3.6%	21.5%	52.0%	45.2%	34.3%	15.9%
Commodities	Broad-based Commodities (BCI)	2.7%	7.2%	12.1%	13.4%	2.9%	11.2%
Commodities	Crude Oil (USO)	-1.6%	-8.8%	-4.0%	-0.7%	0.5%	23.5%

Source: FactSet. Data as of October 31, 2025. 1Y, 3Y, and 5Y numbers

Mega-Cap Tech and Earnings Drive October Gains

Despite the US government shutdown and hawkish commentary at the October FOMC meeting, equities were largely up for the month amid a strong start to the Q3 earnings season, lower than expected inflation, optimism regarding a US-China trade deal, and additional easing in monetary policy. The rally was centered around mega-cap technology as US growth and US large-caps led gains (+3.4% and +2.4%, respectively), while US small-caps and US mid-caps were down (-0.9% and -0.5%, respectively). Bonds mostly fared well as munis rose 1.2%, 7-10 year US Treasuries gained 0.7%, and the US Aggregate Bond Index increased 0.7%. Aside from crude oil (-1.6%), commodities produced positive returns as silver was up 3.9%, gold rose 3.6%, and broad-based commodities increased 2.7%.

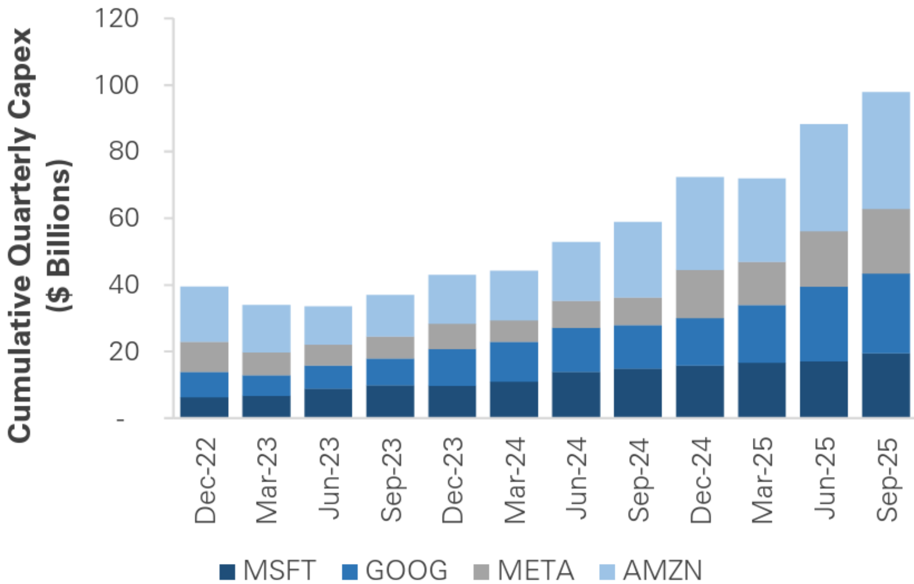
Fed Cuts Again, But Signals Caution Ahead

The Federal Reserve cut the federal funds rate by 25 bps at the October 2025 FOMC meeting, lowering the target range to 3.75–4.00%, marking the second consecutive reduction of the same magnitude in September. For the first time since 2019, the decision saw dissents from both sides as Governor Stephen Miran favored a 50 bps cut, while Governor Jeffrey Schmid preferred no change to policy. In the accompanying statement, officials cited slowing job gains, a further uptick in unemployment, and noted that downside risks to employment have increased, even as inflation has firmed since earlier in the year and remains "somewhat elevated." The Fed also announced that it will halt quantitative tightening at the end of November, effectively ending balance sheet runoff. This policy shift injects additional liquidity into the financial system, is expected to ease upward pressure on longer-term interest rates, and is generally supportive of risk assets. During Chair Jerome Powell's press conference, he reaffirmed the central bank's commitment to returning inflation to 2%, while emphasizing data dependence going forward. Notably, he cautioned that another rate cut in December is "not a foregone conclusion … far from it," sending the odds of a December cut down from about 90% before the meeting to just over 60% afterward, according to the CME FedWatch Tool.

Diverging Outcomes for AI Hyperscalers

Although Q3 earnings have largely exceeded expectations, reactions have been mixed for AI hyperscalers within the "Magnificent 7." While markets remain optimistic about the long-term potential of capital expenditures in data centers and AI infrastructure, recent results show divergence in investor reactions. Meta's earnings were weighed down by margin pressure from rising AI infrastructure costs, and Microsoft delivered strong growth that still fell short of the high bar set by investors. In contrast, Google and Amazon were rewarded as their results not only showed robust top-line growth but also signaled early traction from AI investments, reinforcing confidence in their ability to monetize these initiatives. Market sentiment appears to favor companies that can demonstrate a connection between AI spending and growth, while those facing slower payoffs or margin pressures have seen more negative responses.

Exhibit 2: AI Hyperscaler Capex Continues to Grow

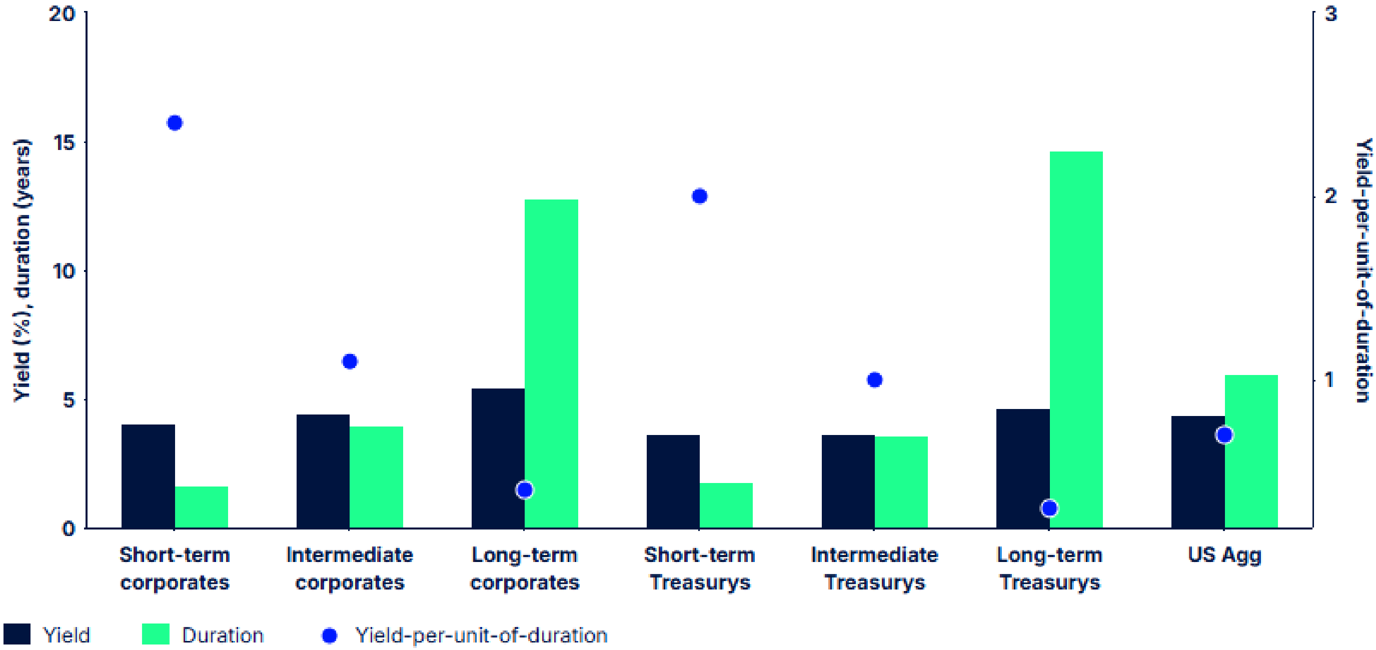


Source: MarketDesk. Various companies SEC filings.

Is Reaching for Yield Worth the Risk?

Per State Street Investment Management, short- and intermediate-term bonds provide a more attractive yield per unit of duration while the long end of the Treasury curve offers limited reward for significantly higher interest rate risk. Although the curve has steepened modestly, it remains flatter than normal as the 2s10s Treasury yield spread lies near approximately 0.5%, only half its historical average. As fiscal deficit and political risks remain elevated, risk-adjusted value favors the front half of the curve, where compensation for duration remains more balanced.

Exhibit 3: Risk-Adjusted Income Profiles Along the Curve

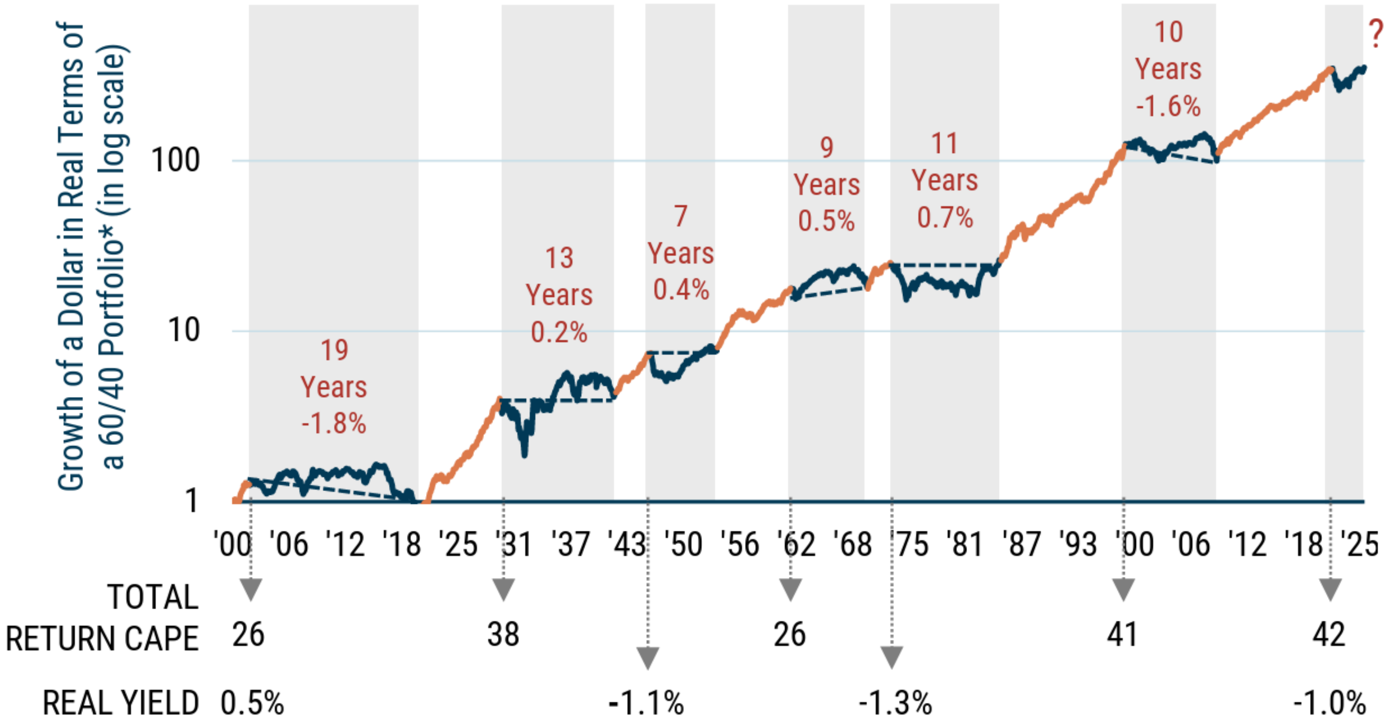


Source: State Street Investment Management, Bloomberg Finance, L.P., as of September 30, 2025. Past performance is not a reliable indicator of future performance. Yield = Yield-to-worst. Duration = Option-adjusted duration. Short-term corporates = Bloomberg US Corporate 1–3 Year Index. Intermediate corporates = Bloomberg Intermediate US Corporate Index. Long-term corporates = Bloomberg Long US Corporate Index. Short-term Treasurys = Bloomberg US Treasury: 1–3 Year Index. Intermediate Treasurys = Bloomberg US Intermediate Treasury Index. Long-term Treasurys = Bloomberg Long US Treasury Index. US Agg = Bloomberg US Aggregate Bond Index.

Positioning Beyond Traditional Frameworks

As highlighted by GMO in Exhibit 4, “lost decades” for the traditional 60/40 portfolio have often followed periods of exceptional performance when both equities and bonds started at elevated valuations, similar to the backdrop today. With US equity valuations high and credit spreads narrow, forward returns for a conventional 60/40 mix could be more challenged. In this environment, investors may benefit from adopting a more flexible allocation approach, allowing exposures to adjust as opportunities change. Within equities, emphasizing value and quality characteristics can help improve resilience, while incorporating international markets, real assets, and alternative strategies can introduce additional sources of return and diversification. Together, these adjustments may help position portfolios more effectively for an environment where the traditional 60/40 framework faces headwinds from starting valuations and evolving market dynamics.

Exhibit 4: 60/40 – “Lost Decades” are More Common Than You Think



Sources: GMO LLC, Bloomberg, Global Financial Data (early history), FactSet (S&P500 returns and CPI), J.P. Morgan (J.P. Morgan GBI United States Traded), Shiller data, Federal Reserve Bank of Philadelphia (U.S. Treasury Yields and Long-term Inflation Expectations). Data as of September 30, 2025. Real yield is the yield on the 10-Year U.S. Treasury minus Philly Fed Long-Term Inflation Expectations (1992-present) or the 12-month trailing CPI (early history). Current CAPE = 42 and Real Yield = 1.8%. 60% U.S. Equities (S&P 500), 40% U.S. Bonds (U.S. Treasuries) rebalanced monthly. Past performance is not indicative of future results.

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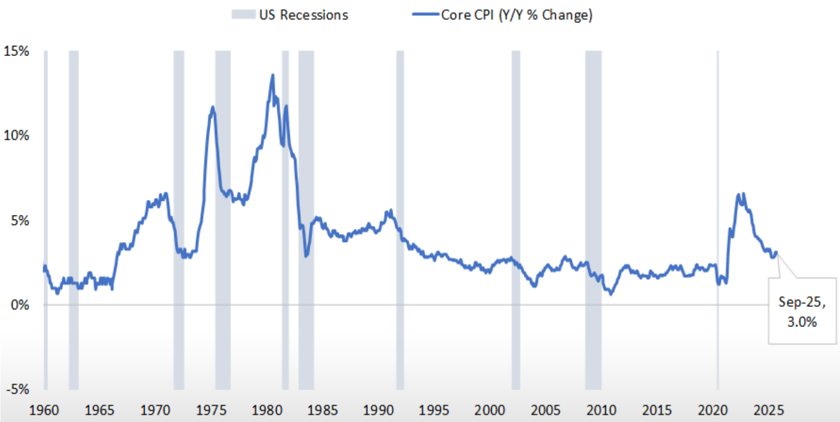
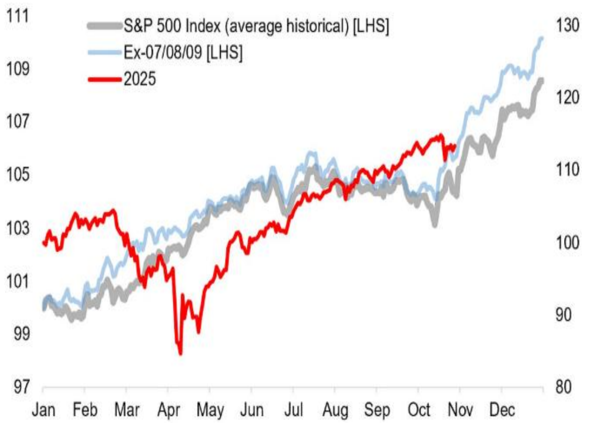
Recent weakness in earnings revision breadth, while in line with historical patterns, remains positive and supportive for equities. Parts of the economy also appear resilient via Q3 earnings growth exceeding expectations and above 10%, Q3 GDP projected near 4%, and PMIs not signaling recession. However, high-income consumers and AI-driven sectors continue to perform well, while the labor market, low-income households, and consumer discretionary areas show signs of strain. Inflation measured by Core CPI (Consumer Price Index) has not meaningfully resurged, with the latest print coming in below expectations, suggesting tariffs have yet to trigger a broader inflationary push and giving the Fed continued flexibility to lower rates. Moreover, S&P 500 multiples historically tend to expand when rate-cutting cycles are coupled with periods of strong earnings growth. While valuations are extended, these dynamics may still favor a year-end rally consistent with seasonal trends.

Exhibit 5: Core Consumer Price Index (CPI) YoY



Source: FactSet, US Bureau of Labor Statistics, Astoria Advisors. Data as of October 24, 2025.

Exhibit 6: S&P 500 Seasonality



Source: Topdown Charts, LSEG.

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