

## MARKET UPDATE & OUTLOOK | Q4 2025

### COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options. We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well. Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

### MARKET RECAP

Momentum stayed with the markets in the third calendar quarter of the year as equities continued on their upward trajectory. The anticipation of the Federal Reserve's interest rate cuts and its eventual arrival in September was enough to keep the markets on the upswing. The S&P 500 Index was up 8.1% for the quarter and is up 14.8% year-to-date including dividends. Bond markets were also higher across the board, with the Bloomberg Aggregate U.S. Bond Index up 0.6% for the quarter and 7.9% year-to-date.

The equity market was led by the Information Technology sector, which was up 13.2% in Q3. It was followed by the Communication Services sector, which was up 12%. The Consumer Staples sector was the only one to finish the quarter in the red, down 2.4%. Factor performance was in favor of growth stocks during the quarter, with the S&P 500 Growth Index returning 9.8% vs. the S&P 500 Value Index being up 6.2%. Small-cap stocks, represented by the Russell 2000 Index, had their best quarter of the year, up 12.4%, finishing Q3 up 10.4% on a year-to-date basis.

The US Dollar, which had a difficult first half of the year, managed to stabilize and record a 1% return in the quarter. Still, this year is proving to be one of the worst on record in terms of the US Dollar's performance. That has greatly benefited international stocks, which remain at the top of the year-to-date leaderboard of global indices. The MSCI EAFE Index of developed markets was up 4.9% in Q3, taking its year-to-date return to 25.8%. Similarly, the MSCI Emerging Markets Index was up 10.9% in Q3, with its year-to-date return standing at 28.2%.

Commodities performance was similar to the previous quarter. The precious metals complex continued its steep ascent, with gold prices rising another 16.1% in the quarter. The energy complex was down in Q3, with the benchmark WTI Crude Oil contract down 4.2% and gasoline and Natural Gas prices down in sympathy. Commodities have continued to provide good inflation protection this year, with the benchmark GSCI Commodity Index up 4.1% in Q3 and up 6.1% year-to-date.

The Treasury bond yield curve shifted lower during the quarter, with the 2-year yield down 10 basis points to 3.62% and the 10-year yield down 8 basis points to 4.15%. As a result, the Bloomberg US Aggregate Index was up 2% in the quarter, with Investment Grade Corporates (2.6%) outperforming the US Treasuries (1.5%). High Yield Corporate bonds were up 2.5%. Unlike in Q2, when they were the best performing bond index, international bonds were down 0.6% in Q3 as per the Bloomberg Global ex-USD Aggregate Index.

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### KEY POINTS

- Investors remain focused on the AI trade and its potential to continue to raise productivity and support the profitability of the US companies in the years to come. We see AI as being impactful but not as immediate as today's valuations of those stocks may reflect.
- The US economy is seeing sluggish job creation and rising inflationary expectations. Such a stagflationary scenario could be a headwind for risk assets.
- The Fed has embarked on another easing cycle in support of the economy. The success of its efforts will depend on convincing bond investors that it can keep long-term inflationary expectations at bay.
- We like Small and Mid Cap equities, which remain attractively priced versus their larger counterparts. Similarly, international equities, along with some exposure to alternatives like REITs and Commodities, appeal to us as valuable diversification options for client portfolios.

MARKET SCORECARD as of 9/30/2025	TOTAL RETURN IN USD	
	Q3	2025 TR
DOW JONES IND AVG	5.7%	10.5%
S&P 500	8.1%	14.8%
NASDAQ	11.4%	18.0%
MSCI EAFE EQUITY (GROSS)	4.9%	25.8%
RUSSELL 2000 INDEX	12.4%	10.4%
MSCI EMERGING MARKET EQUITY (GROSS)	10.9%	28.2%
BLOOMBERG GLOBAL AGG BOND INDEX	0.6%	7.9%
BLOOMBERG INTERM. TREASURY	1.3%	5.3%
BLOOMBERG INTERM. GOVT/CREDIT	1.5%	5.7%
BLOOMBERG 5 YEAR MUNI INDEX	2.2%	4.5%
BLOOMBERG HIGH YIELD CORP INDEX	2.5%	7.2%
ishares S&P GSCI COMMODITY TR INDEX	4.1%	6.1%

*Note:* All returns include invested cash flows expressed in U.S. dollar terms.

## GLOBAL MACROECONOMIC REVIEW & OUTLOOK

The stock market is usually a pretty good barometer of economic health. However, there are times when the market's attention is fixated elsewhere. Investors' attention today remains squarely on the Artificial Intelligence (AI) trade. Fascination with the potential of what the AI-driven future may bring has powered the equity market higher; especially a handful of mega-cap US technology stocks that make up the bulk of the equity indices. In some ways the market has decoupled from the underlying US economy. While the equity market's valuation and concentration have reached levels that compare to some of the high watermark eras, such as the Dot-Com Bubble ('95-00), the underlying economy continues to show mixed signals. The Federal Reserve's quarter-point rate cut in September and additional easing in the coming quarters may help resuscitate the economy, but it will probably take more than that to bridge the expectations gap.

Job creation is the primary barometer for economic growth and the US has seen a decline in both job openings and jobs created this year. While official GDP growth was 3.8% in Q2 according to the government statistics, the US economy's ability to create new jobs has come down from a 120k/month pace at the beginning of the year to just 22k in August. The unemployment rate has ticked up from 4.0% in January to 4.3% in August while new job openings in the US have declined from 7.8 million to 7.1 million during the same time period. Softness in the labor market by itself would not be concerning without the inflationary backdrop at hand. While inflation has come down into a more palatable range around 3% over the last two years, it has remained stubbornly above the Fed's target of 2%. Moreover, there has been a renewed upward pressure on inflation during the past several months after the past couple of years of disinflation. The month of August saw a 0.4% increase in the CPI Index, which was the highest monthly inflation rate since January. The cadence of price increases points to an underlying problem that is likely to persist longer than many market participants think. Higher inflationary expectations have seeped into the consumers' outlook as well, with the September Michigan Consumer survey pointing to a 4.6% 1-yr inflation expectation.

The current economic environment has put the Fed in a difficult position. It can either support economic growth by starting another easing cycle or arrest rising inflationary expectations by keeping rates higher for longer. The Fed has chosen to move in the direction of easing with its quarter-point cut in September, and with current market expectations pointing to two more 25 basis point cuts this year and at least three more next year. While additional liquidity may help support asset prices in the short term, it remains to be seen how it will affect inflationary expectations and bond yields. The last time the Fed chose to embark on an easing trajectory in September of last year, the US government 10-yr bond yield climbed more than 100bps in the subsequent four months. We have yet to see a meaningful move higher in longer-term rates as we write this, but this is something that needs to be closely watched.

## INVESTMENT OUTLOOK

Our investment stance has not changed very much in terms of our relative asset allocation. We believe at this point in the cycle that caution is warranted as the market digests its recent gains and squares up its historically high valuation with the prevailing economic uncertainty. Our focus remains anchored on signposts such as long-term U.S. Treasury bond yields, the U.S. dollar exchange rate, and the Federal budget's trajectory. We think that incremental developments with those will be highly instructive in signaling the likely evolution of market return dynamics.

We remain underweight US equities in favor of international equities relative to the benchmark. The US dollar is in the midst of a convergence of cyclical and secular factors. Those issues include loose fiscal and monetary policies and its status as a reserve currency. We also favor overweight positions in the Small Cap and Mid Cap segments of the US equity market on the basis of their more attractive valuations. In addition, we see them as benefiting more from the Trump administration's legislative agenda. We favor Energy and Utilities over Technology and Consumer Discretionary sectors. While AI investment holds significant potential to unleash the productivity of the US economy in the long term, the prevailing market expectation for almost immediate realization of such promise leaves us somewhat cautious in the near term. Similarly, while the Fed controls short-term interest rates, it has less influence over long-term rates. It is our view that continued lowering of short-term rates is likely to put upward pressure on long-term rates as the term premium increases. More entrenched inflationary expectations are also likely to limit the Fed's ability to stimulate without running the economy too hot. Additional steepening of the yield curve dissuades us from extending duration or investing more aggressively in Corporate and High Yield fixed income securities. As a point of reference, investment grade corporate credit spreads are 75 basis points today and have never been tighter in the last 25 years. This pushes us in the direction of alternatives, such as REITs and commodities.



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