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Economic and Market Outlook

Sept. 30th, 2025

Of Interest Rates and Inflation

“The job of the Central Bank is to worry”

- Alice Rivlin

Section I. Introduction

The above quote from the former Vice Chair of the Federal Reserve explains the cautionary movements of the current Federal Reserve board. Alice Rivlin served as the Vice Chair from 1996 to 1999 under Federal Reserve Chairman Alan Greenspan. That was a period like we are experiencing now with the revolutionary changes brought on by the development and transformation of the internet as a new economic driving industry. Apparently even in that booming period, Ms. Rivlin realized the need for the Federal Reserve to worry.

Fast forward to the present, for the past year we have been hearing from Chairman Jerome Powell about how the board has been cautiously, and patiently, monitoring economic data in order to decide if any adjustments to the current Federal Funds rate would be warranted. With a dual mandate of promoting maximum employment and stable prices, their priority has been to try and bring down inflation from its recent highs of 9.1% in 2023 to a level of 2% while unemployment levels have stayed at historically low levels.

After the most recent Federal Reserve Board meeting, Jerome Powell stated, “It’s time to acknowledge that the risks to the other mandate have grown” and they should move

the policy rate closer to neutral. They were worried enough by the recent weakness in the labor force that a 0.25% cut in the Federal Funds rate was warranted.

Section II. The Federal Reserve and Interest Rates

Having not made any adjustments in the Federal Funds interest rates this year, on September 17 the Federal Reserve Board decided to make their first rate cut of the year. Chairman Powell characterized this easing as an insurance policy as the greater risk to the economy has shifted from inflation to a deceleration in job growth.

"Near-term risks to inflation are tilted to the upside and risks to employment to the downside – a challenging situation," said Powell. "Two-sided risks mean that there is no risk-free path." The increased downside risks to employment led the Committee to move its policy closer to the perceived neutral rate – the point at which interest rates neither fuel nor hinder economic growth. He also stated that the current interest rate stance is "still modestly restrictive" even after last week's rate cut.

Along with reducing the interest rate, the Federal Reserve hinted that there may be additional rate cuts at their next two meetings. Michelle Bowman, a member of the Board of Governors of the Federal Reserve, says that she's concerned about the weakening labor market conditions and softer economic growth. "Increasing signs of weakening labor market conditions provide a basis for beginning to move the policy rate closer to neutral to proactively support the employment side of our mandate," she said. She continues that the Fed still hasn't achieved its 2% inflation goal and feels "we should turn our focus toward the side of the mandate that is showing signs of deterioration or fragility even though inflation is above but within range of our target."

Raphael Bostic, the Federal Reserve Bank of Atlanta President and Federal Open Market Committee member, is still concerned about inflation. He says, "If inflation starts to move further away, and people see that price accelerate, that could lead to a very difficult response, potentially a retrenchment in the economy. So I think it's incumbent upon us to continue to stay vigilant in the fight against inflation."

We now expect the Fed will cut interest rates two more times in 2025. Remember that cutting rates is usually a sign that the economy is slowing, but in this case it is due to concerns that the employment picture is weakening and that it is time to move to less-restrictive monetary policy.

Rates in most European 10-year bonds are steady because of a strengthening European economy. The U.S. 10-year bond still remains relatively more attractive to

international investors for its yield and AA+ credit rating, though the spread is narrowing. The U.K. 10-year yields 4.67% (AA), German 10-year yields 2.75% (AAA), France 10-year yields 3.57% (AA), Italian 10-year yields 3.57% (BBB) and Swiss 10-year yields 0.24% (AAA). These compare to our 4.14% 10-year yield.

Section III. Inflation

As discussed, the other side of the Fed's mandate is inflation. After making great progress in moving the inflation rate closer to the Fed's target rate of 2%, the past few months have seen a slight increase. Much of the increase has been the blame of tariffs.

The tariffs that were enacted earlier in the year started to show up in the inflation numbers this summer. Since tariffs are a tax, they will increase the prices of goods on a short-term basis. But like any other tax, as long as the tax is not increased, the acceleration in prices due to the tax will be short-lived. "Our expectation has been that inflation will move up this year, basically on good prices from tariffs," said Powell. He stated that the Fed doesn't expect tariffs to lead to persistent inflation, but the effect of the tariffs may take some time to work their way through the supply chain.

Currently the Consumer Price Index (CPI) is up 2.9% on an annual basis, and core CPI, which excludes food and energy, which is up 3.1%. Both readings are for August 2025. CPI has increased since our last report by 0.5%. Core CPI increased by 0.3%. While the CPI reading peaked in June of 2023 at 9.1%, the core rate actually peaked in September of 2023 at 6.6%. This is still above the Federal Reserve's 2% target. As expected, the move from 3% to 2% will continue to be slow and difficult.

Average hourly earnings are up 3.7% year-over-year in August and overall inflation is up 2.9% as previously stated. This is a positive for the economy because it means real wages are rising.

The Federal Reserve prefers to use a measure called the Personal Consumption Expenditures (PCE) Price Index to gauge inflation. The reading for PCE in July was 2.6% and the core rate was also 2.9%. August data will be released September 26th. Inflation in the Euro Zone was running at 2.0% on an annual basis in August.

Section IV. The Bull Market

As we stated in our December 31, 2024, report, we expected some types of correction or consolidation in the market from time to time. Corrections are part of

normal volatility, and are healthy for the market. Within the first four months of the year, the S&P 500 index had a correction of 18.9%, reaching a level of 4982.77, on a closing basis. It has since rebounded to 6,700. Remember that a bear market is defined by a pullback of at least 20%. Therefore the bull market is still intact.

Bull markets do not die of old age. We are approaching 35 months in this bull market. Since World War II there have been 13 bull markets and the average gain was 164%, and on average they lasted 57 months. It is also true that recent bull markets have generated higher returns over longer periods of time. On average, the last five bull markets since 1980 have seen stocks advance about 240% over a period of 70 months.

Bull markets end because of Black Swan events or because of recessions in the economy. By definition, Black Swan events cannot be predicted. For reasons cited later in this report, we do not see a recession coming in the near future.

To be clear, in the short term we fully expect more corrections or consolidation in the market from time to time. Corrections of less than 10% are part of normal volatility. In addition, corrections are historically quick and sudden pullbacks while Bear Markets are slow and rolling like a dripping leaky faucet.

In the December 31st report we also forecast a 6% - 9% return for this year. As of this writing, the S&P 500 is up 13%. The average return on the S&P 500 for the last 10 years is around 11%, and over last century the stock market is up on a yearly basis 76% of the time.

Despite recent market fluctuations and uncertainties, the momentum behind AI-driven technologies remains strong. The energy demands of AI will create other opportunities. As companies across industries continue to embrace AI to drive innovation and efficiency, investors are presented with unique opportunities to capitalize on the transformative power of artificial intelligence. The AI revolution is not just a fleeting trend but rather a fundamental shift that is poised to reshape industries and create new opportunities for growth and innovation. In our view this could be the next economic revolution.

Section V. The Recession Model

As we have discussed in past reports, earnings and the economy are the true long-term influences on the stock market. Recessions, or fear of recessions, are the major reason we experience corrections of more than 10%. Corrections of less than 10% are just part of normal volatility and tend to happen multiple times each year.

The official arbiter of recessions in the U.S. is the National Bureau of Economic Research (NBER). They determine when our economy enters and exits recessions. The problem is that usually by the time they declare the official start date of the recession the economy is probably coming out of or already done with that recession, in other words no predictive value.

At Clutinger, Williams & Verhoye, we have developed what we view as a recession indicator, which tracks 5 data sets on a monthly basis. If 3 of the 5 indicators are negative and the S&P 500 is below its 40 week moving average, it is a very strong indication that a recession is near or may already be underway.

Indicator number one compares the current monthly unemployment rate to its 12 month moving average. As of August, the unemployment rate was 4.3% and the 12 month moving average was 4.15%. By being above the moving average this indicator has stayed negative.

Indicator number two is represented in Chart #1. This represents the year over year percentage change of Advance Real Retail and Food Service Sales. This is one method to measure the strength of the consumer. Currently the reading is 2.0% for August, so this indicator remains positive and improved since our last report.

Indicator number three is represented in Chart #2. This shows the year over year change in Industrial Production. This indicator has remained positive. It currently sits at 0.90% for August 2025.

For indicator number four (Chart #3), we look at Total Nonfarm Payrolls divided by the Civilian Labor Force Level on a year-over-year percentage change basis. This indicator stands at -0.42% showing a slight weakness in employment. Therefore, this indicator is negative.

Indicator number five (Chart #4) represents the Average Weekly Hours of Production and Nonsupervisory Employees-Manufacturing on a year-over-year percentage basis. Currently the reading is 0.49%, so this indicator remains positive.

Currently three of the five indicators are positive and the S&P 500 Index is 11.11% above its 40-week moving average as of September 19. The S&P 500 is above its 40-week moving average so this model is not giving a recession warning sign. We will be closely monitoring these indicators in the coming months.

The above indicators are only updated on a monthly basis. To offset this situation, we also track two other indicators. They are both indicators that are updated more frequently (on a weekly or daily basis) and we consider them as early recession indicators. Both are somewhat volatile, so we track three-month moving averages. These two indicators are separate and independent of the first five and either one can indicate the possibility of recession on its own.

The first one is the Aruoba-Diebold-Scotti Business Conditions Index, which is updated on a daily basis and published by the Philadelphia Federal Reserve. The 91 day moving average is at -0.14 currently. The divining line for entering and exiting recessions is -0.8.

The second indicator for recessions is the Chicago Fed Business Activity Index. It is reported weekly and the divining line for entering recessions is -0.7. The three month moving average stands at -0.18.

In summary, the two "early warning signs" are not predicting recession at this time.

Section VI. Market Psychology

For decades we have measured market psychology using price and volume data in the short and long term from the Dow Jones Industrial Average as well as a 17 week moving average of advancing and declining stocks on the New York Stock Exchange.

Currently, 9 out of 12 of our price/volume indicators are positive. The S&P has returned to 6,700. But that doesn't necessarily mean the end of the rally. The market needs corrections from time to time in the short term to stay healthy and growing over the long term.

Our advance/decline line has been positive for the last six weeks and sits at 57.9%, and is reflecting the recent rally while expressing there may still be some room to the upside by not being overextended.

Our technical model measures the first and second derivative of price and volume for the market. We have developed this model to recognize patterns and spot buy and sell signals from reviewing years of historical data. This model is providing positive signs and our proprietary charting is reflecting a pattern seen during past bull markets as previously cited in this report.

Section VII. The Economy

Indexes that measure manufacturing data are mixed. The Philly Fed Manufacturing Index has turned positive. After slipping to -4.0 in June of 2025, it has since rebounded to 23.2 in September. The Empire State Manufacturing Index fell to -20.0 in March, but after reaching positive territory in July and August, its September reading was -8.7. The national ISM manufacturing index was 48.7% in August and the ISM services index improved to 52.0% (above 50 is considered growth, above 55 is considered exceptional growth).

Multiple Wall Street and Federal Reserve predictions for Gross Domestic Product (GDP) have stayed around 1.7% for 2025. GDP for the second quarter was 3.8%, up from -0.5% level in the first quarter. GDPNow is estimating a GDP of 3.3% for the third quarter.

Section VIII. Conclusion

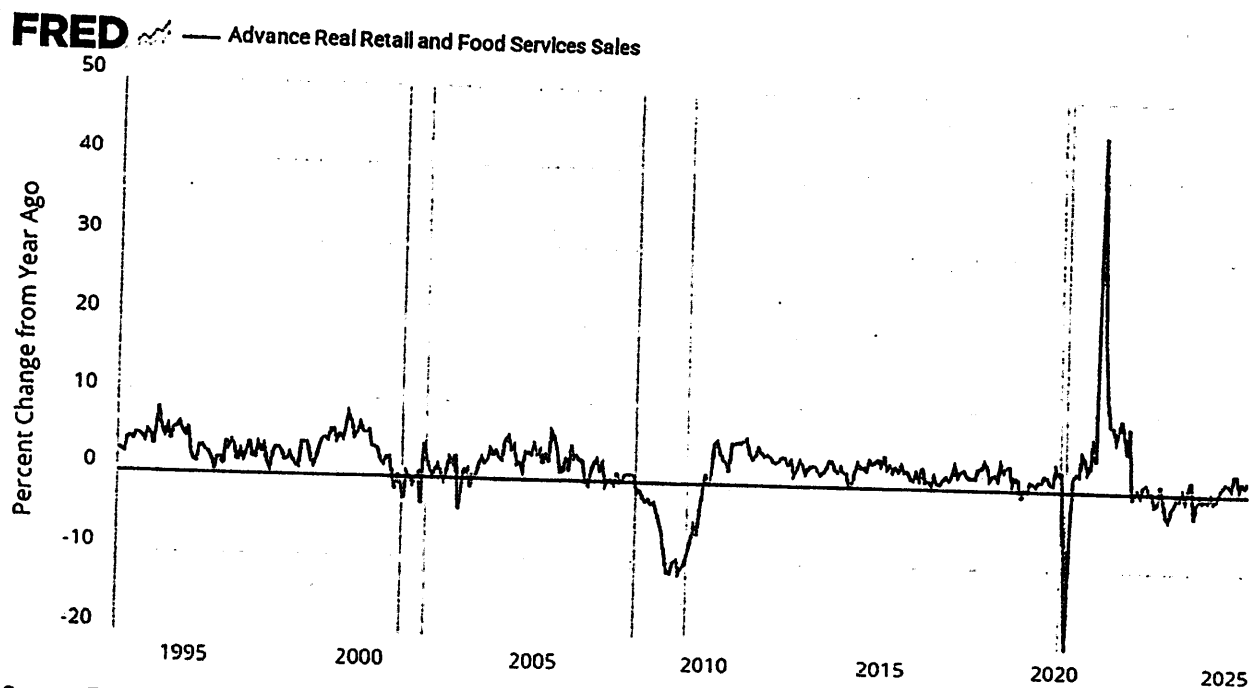
The market has had a strong third quarter. This can primarily be attributed to the expectations of the Federal Reserve being less restrictive with their monetary policy, as well as the highly weighted influence of tech stocks benefitting from the growth of Artificial Intelligence technology in the indexes. While the market-weighted S&P 500 index is up 13% year to date, Yahoo Finance calculates that an equal-weighted return for the index is about 7.5%.

We continue to be optimistic moving forward. As previously stated, we expect a positive, but more muted, return for 2025. As stated earlier, after moves like we have just experienced over the past few months, short-term corrections would not be surprising and are usually healthy for the market. However, we feel that the indicators show that keeping a longer view of the market will be rewarding.

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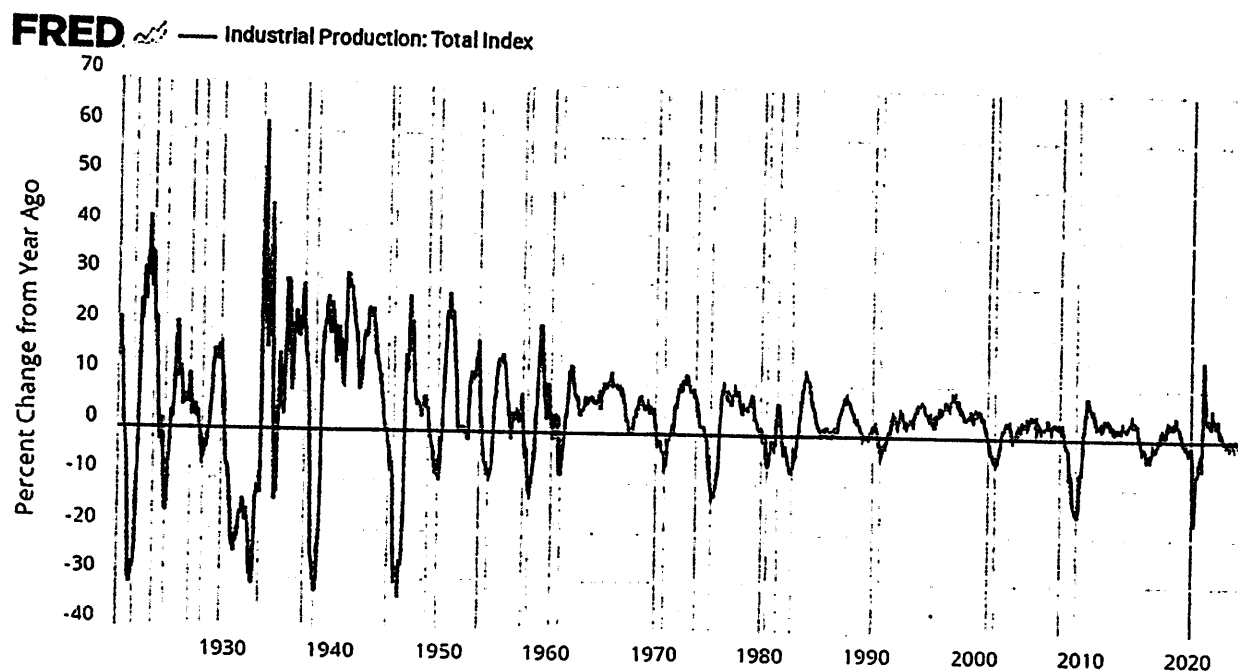
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Chart #1



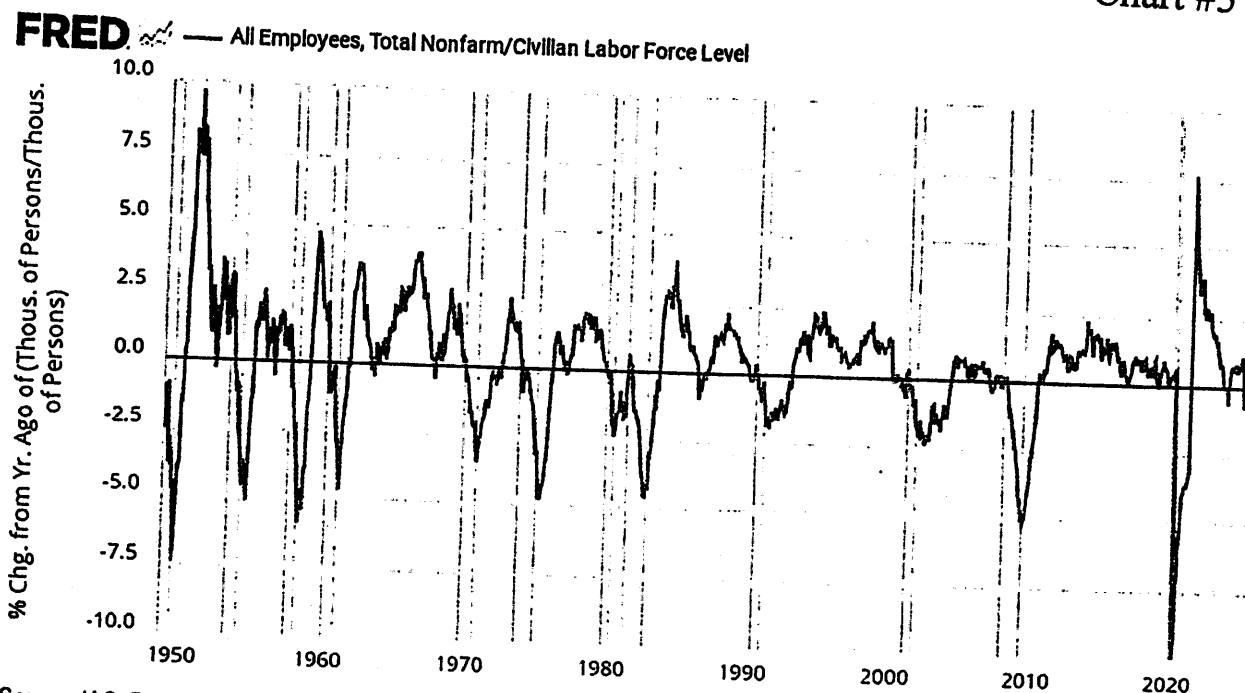
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Chart #2



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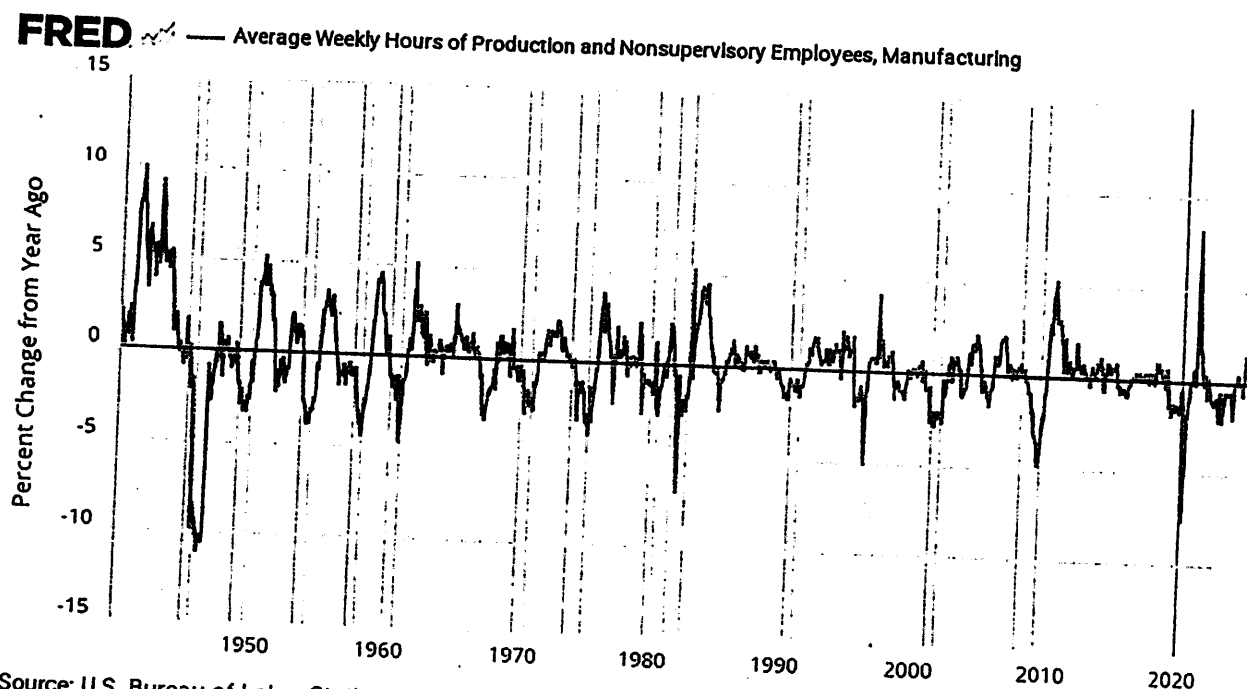
Chart #3



Source: U.S. Bureau of Labor Statistics via FRED®
 Shaded areas indicate U.S. recessions.

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Chart #4



Source: U.S. Bureau of Labor Statistics via FRED®
 Shaded areas indicate U.S. recessions.

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