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Our simplest synopsis of the third quarter of 2025 is “line go up.” Grammatically incorrect and overly simplified, yes, but the third quarter was one where essentially everything worked and making money was easy.

Domestic stocks slightly outpaced their international peers with the S&P 500 advancing 8.1% and the MSCI ACWI ex-US index of global stocks up about 6.9% (both inclusive of dividends), but for the year international stocks’ advantage over the S&P 500 is about 11 percentage points¹. Bonds offered a solid 2% return, as measured by the Bloomberg US Aggregate Bond index. Although we don’t report on them often, gold continued its run, advancing by about 15% in the quarter, outshining Bitcoin’s appreciation of about 6.5%.

After such strong performance, it’s tempting to think that a pullback or market selloff must be coming, but as always, *we don’t know what is going to happen*. Instead, we remain disciplined and committed to trying to avoid uncompensated risks. The concurrent strength of “risk on” assets (like stocks and Bitcoin) at the same time as “risk off” assets (like bonds and gold) suggest uncertainty about how the short- to intermediate-term will play out.

While many factors will contribute to the path forward, Federal Reserve Chairman Jerome Powell will be at the center of attention. We do not envy the position of Fed Chair Powell and his colleagues on the Federal Open Market Committee (FOMC) at the Fed. Their decision to reduce the Federal Funds Rate at their September meeting by 0.25% was highly telegraphed and came as a surprise to no one, but everyone wants to know what’s next.

The Federal Reserve of Atlanta’s GDPNow estimate of third quarter growth was recently revised upwards to an annualized 3.9%; an encouraging data point, but there’s other evidence that suggests the economy is slowing.²

The unemployment rate has risen to 4.3% from its post-pandemic low of 3.5%.³ That rise appears to be attributed to an increase in the labor force participation rate, which is generally desirable because it means more potential workers are available to contribute to economic growth.⁴ However, workers are facing a more challenging job market.

The Bureau of Labor Statistics’ September report showed slight net job losses in June, the first monthly losses since the height of the pandemic.⁵ Payroll processor ADP recently published their September survey that suggests June might not have been a one-off, with slight job losses in August and September; especially among businesses with less than 500 employees, which employ nearly half

¹ All index return data from YCharts

² <https://www.atlantafed.org/cqer/research/gdpnow>

³ <https://fred.stlouisfed.org/series/UNRATE>

⁴ <https://fred.stlouisfed.org/series/CIVPART>

⁵ <https://www.bls.gov/news.release/empst.nr0.htm>

of US workers.⁶ Additionally, long-term unemployment, or those who have been unable to find work for at least 27 weeks has been rising.⁷

Given that consumers drive more than two-thirds of the US economy (through everything from mortgages to groceries to healthcare to travel), the health of the US consumer is critical for our overall economy. Discouragingly, the University of Michigan's September Consumer Sentiment survey, while fractionally above the levels of this spring, are still near 70-year lows with participants citing concerns over the job market and higher prices.⁸

Worries over higher prices are supported by the Personal Consumption Expenditures Index (PCE)—the Fed's preferred inflation gauge—creeping higher since April to its latest reading of 2.7%.⁹ Both above the Fed's 2% target and moving in the wrong direction of late.

The Fed's dual mandate is to conduct monetary policy with the aim of achieving maximum employment and stable prices. Simplistically, if the economy is weak, the Fed can be "accommodative" by lowering rates to try to stimulate economic activity. Conversely, if the economy looks to be running hot with prices levels increasing too fast, they can be "restrictive" and try to rein in conditions by raising interest rates.

Clearly markets are optimistic that the Fed's current stance and communicated plan for interest rates is striking the correct balance to keep our economy growing and avoid recession. We generally agree but believe a degree of caution is warranted.

Normally, we expect inflation would subside in an economic slowdown, but we can imagine a situation where inflation persists amidst a deteriorating job market, essentially forcing the Fed into choosing whether to focus on maximizing employment or stabilizing prices.

In our current "stagflation light" environment (stagflation being the economist portmanteau jargon for a stagnant economy, with elevated price levels, and high unemployment), the potential risks to incorrect monetary policy could be amplified.

Nobody seems to be making the case for raising interest rates from current levels, but President Trump and his latest appointee to the FOMC, Stephen Miran, have been vocal about their desire for dramatically lower interest rates. While it's difficult to predict exactly what might happen in such a scenario, we suspect that equities would continue to do well, but inflation concerns could prompt bond investors to demand a higher yield to compensate for the risk of inflation eroding their returns (remember that longer-term bond yields are set by supply and demand rather than the Federal Funds Rate). Since bond yields move inversely to their price, higher bond yields would mean a selloff in the value of bonds.

We continue to prefer shorter-term bonds, including short-term Treasury Inflation Protected Securities (TIPs). While they do not offer the same counterbalance to equities as longer-term bonds, their prices are less volatile. And at least for the time being, their yields are acceptable.

⁶ <https://adpemploymentreport.com/>

⁷ <https://www.bls.gov/charts/employment-situation/unemployed-27-weeks-or-longer-as-a-percent-of-total-unemployed.htm>

⁸ <https://www.sca.isr.umich.edu/>

⁹ <https://www.bea.gov/news/2025/personal-income-and-outlays-august-2025>

On the equity side of our portfolios, the concentration risk of the Magnificent 7 continues. Astoundingly, Nvidia (NVDA) has a market capitalization of more than \$4.5 trillion, which makes it larger than most international stock markets, including countries like France, Germany, Canada, and the United Kingdom. Call us crazy, but if we had the option to own NVDA in its entirety or being the sole owner of all German publicly traded companies (e.g. Mercedes-Benz, BMW, SAP, Siemens, Allianz, and Rheinmetall), we would be hard pressed to choose NVDA. We still have exposure to the Mag 7 through our broad index exposure, but we believe more attractive investment opportunities exist elsewhere, particularly in international markets and smaller stocks.

As we enter the fourth quarter, we wish you all a healthy, happy, and peaceful holiday season. We are grateful to our clients for entrusting us with their capital and appreciate the growing number of referrals we are receiving. As always, if you ever have any questions or concerns about your finances, or just want to talk shop, we are here to serve you.



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