

Market & Economic Review

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The following market update was provided by Vanguard Investment Strategy Group and is forwarded by Independent Wealth Management.

Vanguard Market Perspectives Key Takeaways

- Three interest-sensitive sectors help explain the clamoring for rate cuts. But investors should pay greater attention to structural challenges than to rate-cut “noise.”
- Our view is that higher medium- and long-term interest rates are here to stay and will continue to shape the investment environment.

3Q25 Benchmark Returns

	3Q	2025
Equities		
S&P 500 Total Return Index	8.1%	14.8%
Russell Index 1000 w/Dividend	8.0%	14.6%
Russell Index 2000 w/Dividend	12.4%	10.4%
Russell Index 3000 w/Dividend	8.2%	14.4%
MSCI Developed EAFE (USD)	4.8%	25.7%
MSCI Emerging Markets (USD)	10.1%	25.2%

Alternatives

Credit Suisse Hedge Fund Index	2.4%	6.8%
DJ Wilshire Global REIT Index	3.7%	5.3%
iShares S&P US Pref Stock Index	1.9%	-0.6%
S&P GSSI Natural Resources Index	11.7%	17.4%
Barclays High Yield Bond Index	2.5%	7.2%

Fixed Income

90 Day Treasury Bill	1.1%	3.2%
Barclays Muni Bond Index	3.0%	2.6%
Barclays Aggregate Bond Index	2.0%	6.1%
Barclays Global Bond Index	-1.1%	8.3%

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Vanguard's outlook for financial markets

Our 10-year annualized nominal return and volatility forecasts are shown below. They are based on the June 30, 2025, running of the Vanguard Capital Markets Model® (VCMM).

EQUITIES	RETURN PROJECTION	MEDIAN VOLATILITY
U.S. equities	3.3%–5.3%	15.2%
Global equities ex-U.S. (unhedged)	5.1%–7.1%	18.8%
Developed markets ex-U.S. equities (unhedged)	5.7%–7.7%	18.2%
Emerging markets equities (unhedged)	3.1%–5.1%	25.3%
U.S. value	5.8%–7.8%	18.7%
U.S. growth	1.9%–3.9%	16.2%
U.S. large-cap	3.1%–5.1%	15.0%
U.S. small-cap	5.0%–7.0%	19.9%
U.S. real estate investment trusts	3.0%–5.0%	18.4%
FIXED INCOME		
U.S. aggregate bonds	4.0%–5.0%	6.3%
Global ex-U.S. aggregate bonds (hedged)	4.3%–5.3%	4.9%
U.S. Treasury bonds	3.8%–4.8%	6.7%
U.S. credit	4.2%–5.2%	6.5%
U.S. high-yield corporate bonds	4.7%–5.7%	9.7%
Emerging markets sovereign bonds	5.4%–6.4%	11.2%
U.S. Treasury Inflation-Protected Securities	2.8%–3.8%	5.1%
U.S. mortgage-backed securities	4.4%–5.4%	4.2%
U.S. municipal bonds	3.5%–4.5%	4.8%
U.S. high-yield municipal bonds	4.0%–5.0%	7.8%
U.S. cash	3.0%–4.0%	1.1%
U.S. municipal cash	2.5%–3.5%	0.5%
U.S. COMMODITIES	4.5%–6.5%	16.7%
U.S. INFLATION	1.5%–2.5%	1.8%
VANGUARD U.S. DOLLAR INDEX	-0.7%–0.3%	8.4%

Notes: Equity forecasts reflect a 2-point range around the 50th percentile of the distribution of probable outcomes. Fixed income forecasts reflect a 1-point range around the 50th percentile. More extreme returns are possible. These probabilistic return assumptions depend on current market conditions and, as such, may change over time. Source: Vanguard Investment Strategy Group.

IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of June 30, 2025. Results from the model may vary with each use and over time. For more information, see the Notes section at the end of this article.

Markets in focus

Looking beyond the Fed rate cut

Paul Volcker—the late Federal Reserve chairman whose punitive interest rates tamed the U.S. Great Inflation of the 1970s and early 1980s—once quipped that it was easier to cut interest rates than to raise them, because people like rate cuts better.

More recently, the Fed cut its federal funds rate target by a quarter percentage point, to a range of 4.00%–4.25%, on September 17. Its first reduction of the year, after a full percentage point's worth of cuts in 2024, came amid inflation expectations that remain in check and hints of labor market weakening.

But while the desire for lower rates is understandable—because they reduce borrowing costs and, by extension, support equity markets—it's worth asking: What lies beyond the noise of rate cuts? More importantly, how will the investment landscape evolve as we get through a prospective cutting cycle that has just begun?

Three sectors that have been particularly sensitive to the post-2022 higher-rate environment illustrate the limits of possible rate cuts in the face of underlying challenges.

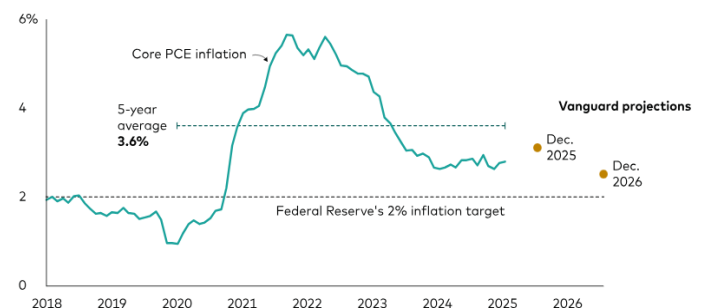
Housing, private equity, small-caps, and the rate environment

Housing remains the largest source of wealth for most Americans. For years, a combination of low interest rates and chronic underbuilding supported rising home prices. But the sharp rate hikes of 2022 and 2023 have stalled the market at unaffordable levels. Demand has weakened as mortgage rates have surged, while supply remains constrained as existing homeowners cling to low-rate mortgages. The result is a dormant market—too expensive for new buyers and too illiquid for sellers. A rate cut might offer some hope, but it won't solve the deeper affordability and supply issues.

Private equity thrived in a world of cheap debt and ever-expanding multiples. But the golden era of easy exits—where sponsors could count on rising public market valuations to offload portfolio companies—is over. With borrowing costs elevated and exit opportunities constrained, private equity firms are increasingly trading assets among themselves or accepting lower returns. The \$11 trillion industry's aggressive use of leverage, which once defined the model, is now being reined in, forcing a strategic rethink.

Small-cap companies relied heavily on short-term debt to sustain operations. In a low-rate world, that approach was manageable. But many of these firms have become structurally weaker over time, with each debt rollover bringing higher interest costs. A growing share of small-caps are now earning less than twice what they need to cover interest payments, a sign of potential distress. These firms are not just hoping for rate cuts but depending on them.

Inflation has remained above the Fed's target for nearly five years and counting



Note: The year-over-year Personal Consumption Expenditures Price Index Excluding Food and Energy, also known as core PCE, is closely watched by the U.S. Federal Reserve in setting monetary policy.

Sources: Vanguard calculations, using data through June 2025 from the U.S. Bureau of Economic Analysis.

Two essential interest rate realities

Given such pressures, it's no surprise that every hint of a dovish Fed pivot is met with enthusiasm. But two realities about the yield curve—and the broader rate environment—are worth keeping in mind.

First, the short end of the curve will continue to be shaped by the Fed’s dual mandate of ensuring both price stability and maximum sustainable employment. Although inflation has come down meaningfully from its peak, it remains sticky. This is partly due to supply-side forces, including tariffs and an immigration slowdown.

At the same time, the labor market, though showing signs of softening, remains in balance by historical standards. These dynamics suggest that the Fed’s path to sustained rate cuts is narrow. With inflation poised to remain above its 2% target for a fifth consecutive year, the Fed is unlikely to ease the policy rate substantially—unless inflation somehow makes a more decisive move toward target sooner.

Second—and more importantly—many sectors would benefit more from lower medium- and long-term rates than from a cut in the shorter-term policy rate. But long-term yields are shaped not just by near-term Fed policy, but also by expectations about future rates and the premium that investors demand for holding longer-duration bonds.

And here, structural forces may be working against a sustained decline in yields. Key factors include productivity gains related to AI (and increased demand for funding for investment) as well as the growing burden of public debt. Such factors are likely to keep long-term rates elevated. As the current Fed chairman has noted, central banks can do little about structural changes.

So where does that leave investors?

We suggest that investors focus not on the short-term theatrics of potential rate cuts, but on the longer-term forces shaping returns. In this environment, where medium- and long-term rates remain high, markets are likely to reward companies that can deliver consistent, high-quality earnings growth. Think the tech-sector growth companies in the U.S., if they can maintain their momentum.

At the same time, the continuation of a higher-for-longer rate environment is likely to lead weaker firms to seek greater flexibility through creative financing solutions, including liability-management exercises and non-cash payment-in-kind interest modifications. Only time will tell whether such measures forestall formal debt restructuring or bankruptcy.

Meanwhile, fixed income remains appealing. With yields at historically attractive levels, especially relative to historically low equity dividend yields, demand for bonds is likely to remain strong. This could further reshape portfolio allocation approaches for the years ahead.

Although the clamor for rate cuts is broad-based, the longer-term impact on the return environment is much less clear. For long-term investors, the real story is not whether the Fed cuts once or twice more in the remainder of 2025, but how they adapt to a world where structurally higher rates—and the forces behind them—are likely here to stay.

As the old saying goes, “The secret to happiness is to lower expectations.” Perhaps the corollary for investors is this: The path to wise decision-making lies in embracing a realistic outlook—one that focuses on the emerging trends that will outlast the next cycle.

Economic forecasts

Year-end outlook by country	GDP growth	Unemployment rate	Core inflation	Monetary policy
Canada	1.25%	7.50%	2.50%	2.25%
China	4.80%	5.10%	0.50%	1.30%
Euro area	1.10%	6.30%	2.10%	1.75%
Japan	0.70%	2.40%	2.40%	0.75%
Mexico	0.50%–0.75%	3.00%–3.50%	4.00%	7.50%
United Kingdom	1.30%	4.80%	3.00%	3.75%
United States	1.40%	4.50%	3.10%	4.00%

Notes: Values are approximate. GDP growth is defined as the annual change in real (inflation-adjusted) GDP in the forecast year compared with the previous year. Unemployment rate is as of December 2025. Core inflation is the year-over-year change in the Consumer Price Index, excluding volatile food and energy prices, as of December 2025. For Canada, monetary policy is the BoC’s year-end target for the overnight rate. For the United Kingdom, monetary policy is the Bank of England’s bank rate at year-end. For the euro area, monetary policy is the European Central Bank’s deposit facility rate at year-end. For Mexico, monetary policy is the Bank of Mexico’s year-end target for the overnight interbank rate. For China, monetary policy is the People’s Bank of China’s seven-day reverse repo rate at year-end. For Japan, monetary policy is the BoJ’s year-end target for the overnight rate. For the United States, monetary policy is the upper end of the Federal Reserve’s target range for the federal funds rate at year-end.

Source: Vanguard.

As always, we are appreciative and humbled by your trust and confidence.



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Notes: All investing is subject to risk, including the possible loss of the money you invest. Investments in bonds are subject to interest rate, credit, and inflation risk. Investments in stocks and bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk. These risks are especially high in emerging markets.

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