

## Q4 2025 investment outlook

# Momentum: A function of mass and velocity



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### Executive summary

Physics envelopes the natural world, and third quarter investment performance reflects momentum emerging from the second quarter's sharp asset declines and subsequent bounces. News flow remained voluminous and wide-ranging, including global trade, monetary policy, a possible government shutdown, consumer health and an active corporate earnings season. Inflation and a slowing labor market emerged as dominant and conflicting macroeconomic factors, especially for policymakers. Nonetheless, asset prices moved higher across most major categories, rewarding diversified investors.

We retain a positive outlook as we enter 2025's final quarter. Our top-down (macroeconomic variable analysis) and bottom-up (individual public and private company research) approach offers a contrarian view to consensus forecasts. We see growth prospects improving relative to current estimates, and while inflation remains elevated, price pressures may alleviate more quickly than current expectations. While we anticipate ongoing fundamental momentum, risks include weakening consumer spending, further trade and geopolitical uncertainties, accelerating inflation and stretched valuations within certain assets.

What follows represents U.S. Bank's most senior investment professionals' views across major research categories. While we include detailed information, for readability we do not include an exhaustive research download. As such, if you would like more detail on information shared or receive our thoughts on issues not covered, please do not hesitate. Thank you for your trust. We wish you continued momentum and success as we enter the year's final stanza.

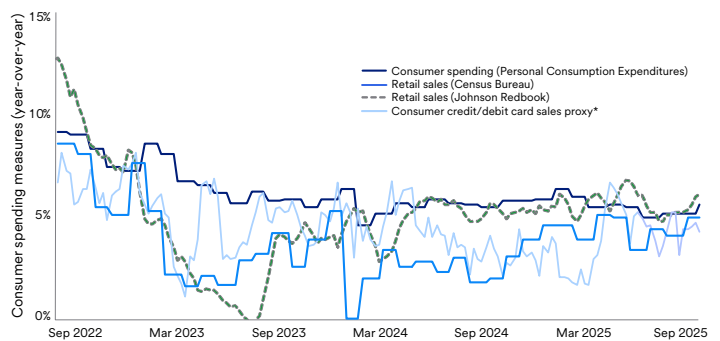
## Global economic views

**Quick take:** Policy stimulus, solid economic growth and rising corporate earnings support surging asset prices despite ongoing tariff uncertainty and a weakening U.S. labor market. Recent interest rate cuts across the globe and stimulative U.S. legislation highlight key policy tailwinds. U.S. consumer spending continues to drive economic growth despite lingering inflation and slow hiring. Economic activity outside the U.S. expanded, albeit at a slower pace, despite budget concerns and political upheaval in parts of Europe. Trade negotiations will influence growth and inflation prospects, with U.S.-China relations taking center stage as we close out 2025.

- **Solid U.S. consumer spending is boosting economic and corporate earnings growth expectations**, highlighting investor optimism that recent legislation and anticipated interest rate cuts will continue supporting consumer activity. Large downward job growth revisions indicate some labor market deterioration. Slowing job gains and lingering inflation pose primary risks to consumers and broader economic growth, but this has yet to dent aggregate consumer behavior.
- **Persistent policy tailwinds support consumer, corporate and economic fundamentals.** Investors anticipate the September Federal Reserve (Fed) meeting to initiate an interest rate cutting sequence in coming quarters, while other major central banks have already cut policy rates multiple times this year. The One Big Beautiful Bill Act's tax cuts boosted profit expectations, according to recent corporate executive comments, while economists expect consumers will see additional benefits during the 2026 tax filing season.
- **Trade and tariff uncertainty present inflation and profitability risks but have yet to derail economic growth.** U.S. economic data exceeded economists' forecasts in the second and third quarters, but analysts continue to forecast subdued foreign developed economic growth prospects. Core goods inflation has accelerated moderately, with business surveys signaling ongoing pricing pressure and plans to eventually pass higher prices along to consumers. U.S. tariff revenue continues to increase, indicating likely additional corporate profit and consumer price impacts. U.S.-China negotiations warrant continued attention.

- **Conflicting data clouds foreign developed markets' forward growth prospects** Purchasing manager surveys indicate expanding manufacturing and service sector activity, and the European Central Bank has cut rates by 1% this year through September. However, economists forecast subdued growth across the region due to high European unemployment, elevated Japanese consumer costs and fiscal concerns driving higher French and United Kingdom long-term government borrowing costs.

### Consumer spending



Sources: U.S. Bank Asset Management Group Research, Bloomberg; January 31, 2022-September 21, 2025.

\*Subset of 20 million consumer debit and credit card transactions for largest 25 companies in the S&P 500.

## U.S. equity markets

**Quick take:** As we enter the fourth quarter, rising corporate earnings and economic growth estimates offset high valuations, supporting a positive domestic equity outlook. Outside the U.S., cheaper valuations balance somewhat weaker fundamentals, creating geographic opportunities. While negative trade sentiment may re-emerge, tariff concerns have not dented recent performance. Artificial intelligence (AI) advancements favor the Information Technology and Communication Services sectors, as well as Industrials and Utilities firms.

- **Analysts upgraded earnings growth expectations on resilient consumer spending, with U.S. stocks commanding a notably higher valuation premium amid solid fundamentals.** Analysts raised their full-year U.S. large-company earnings growth forecasts to 9% from 7% a quarter ago and now expect 5.5% growth for mid-cap stocks and 3.1% growth for small companies. Large-cap

S&P 500 valuations remain elevated but not extreme, at a trailing 12-month price-to-earnings multiple of 25.4 times, above the 35-year average of 20.2 times. Absent accelerating inflation, elevated U.S. large-cap valuations can persist for an extended period by generating higher profit margins and stronger earnings growth. Smaller and mid-sized companies trade at cheaper valuations and often hold more debt, suggesting additional Fed rate cuts could aid profitability via lower interest costs and upgraded valuations.

- **Cheaper foreign stock valuations offset softer corporate and economic fundamentals.** The potential for better-than-expected growth and improving investor sentiment creates opportunities to enhance non-U.S. equity exposure. Despite most major developed foreign central banks delivering growth-supportive interest rate cuts, analysts continue to forecast near zero earnings growth for foreign equities in local currency terms this year, though estimates in U.S. dollar terms improved to 7.9% growth from 7.2% last quarter. Analysts have lowered emerging market equity earnings growth expectations to 14% from 18% last quarter. Easier monetary policy and U.S. dollar weakness support developed market earnings, while tariff concerns temper investors' emerging market expectations.
- **AI advancements create investment opportunities across multiple sectors.** Data drives AI, increasing semiconductor chip design demand, data capture, storage and processing, software/analytics and data security. Lower costs and higher demand should benefit companies across these industries. Utilities maintain a favorable long-term outlook as data centers, electric vehicles and reshoring efforts reshape electrical load profiles and peak demand.
- **Consumer strength portends a promising holiday selling period.** We expect healthy consumer spending throughout the season, prioritizing product newness, value and convenience. Higher equity prices, lower interest rates and stable inflation are fueling this trend through the wealth effect. However, ongoing tariff uncertainty may prompt higher-income groups to trade down in search of value — consistent with third-quarter trends.

## U.S. equity performance

Index	2025*	2024
S&P 500	13.7%	23.3%
<b>S&amp;P 500 Sectors</b>		
Communication Services	23.7%	38.9%
Consumer Discretionary	4.7%	29.1%
Consumer Staples	2.0%	12.0%
Energy	4.3%	2.3%
Financials	11.5%	28.4%
Health Care	1.2%	0.9%
Industrials	17.1%	15.6%
Information Technology	21.7%	35.7%
Materials	7.7%	-1.8%
Real Estate	3.5%	1.7%
Utilities	15.1%	19.6%

\*Through September 30, 2025; excludes dividends.

Sources: FactSet Research Systems, S&P Global.

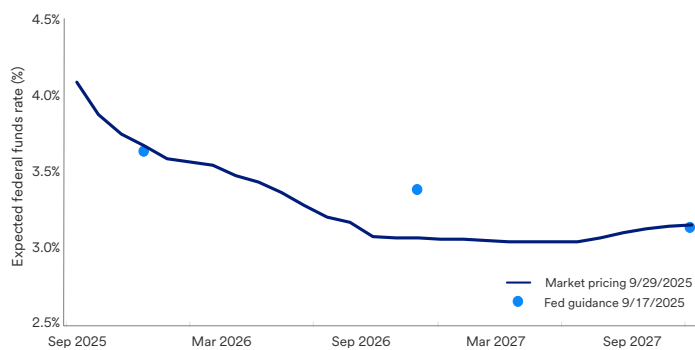
## Bond markets

**Quick take:** We see bonds as a critical ingredient of diversified portfolios despite moderating yields. Shifting Fed policy and investor policy expectations drove bond price changes in the third quarter and should continue to primarily influence prices in the fourth quarter. Investors anticipate aggressive rate cuts, with two more cuts this year and two to three more in 2026. Strong issuer fundamentals support elevated corporate bond valuations, while municipal bonds offer compelling value for highly taxed individuals. Structured credit and reinsurance also present enhanced yield opportunities and solid fundamentals for qualified investors.

- **Investors expect the Fed to cut interest rates two more times before year-end.** At the Fed's September meeting, officials cut rates for the first time this year and projected two more cuts by year-end, citing the balance between rising labor market risks and lingering inflation risks. Investors interpreted the September rate cut as reactive to recently revised job growth figures as far back as 18 months ago, rather than a sign of weak economic growth.
- **Treasury yields fairly compensate investors for risks, although fluid Fed policy could drive volatility.** Ramping investor rate cut expectations led bond yields lower and prices higher in the third quarter. The uncertain tariff impact on already-elevated inflation continues to present lingering concerns for the Fed and bond investors. Treasury prices have not evidenced fiscal deficit concerns despite headlines questioning long-term budget sustainability. Elevated federal deficits persist, but growing tariff revenue helped lower the deficit to 6.2% of gross domestic product (GDP) from as high as 7.2% earlier this year.

- **Improving investor sentiment and strong fundamentals led to rising corporate bond valuations while compelling municipal bond yields persist.** Investment-grade corporate bonds ended the quarter with yields roughly 0.7% above Treasuries, near historical lows. Comparable quality municipal bonds offer tax-equivalent yields approximately 2.2% above Treasuries for investors in the top federal tax bracket. Riskier corporate issuer defaults continued at a normal rate in the third quarter, partly due to issuers restructuring debt obligations to enhance repayment flexibility.
- **Compelling yields across the bond market create opportunities to diversify current income sources with exposures to unique bond categories.** Non-agency mortgages lack government backing but offer structured investor protection against underlying mortgage pool losses and have yields above 6% in many instances. Low mortgage delinquencies persisted in the third quarter, with many homeowners benefiting from locking in low-cost mortgages prior to interest rate increases in 2022. High-quality collateralized loan obligations exhibit similar structural protections from individual loan failures and currently generate close to 6% annual income. Reinsurance pays more than 10% annual income to compensate for natural catastrophe damages. Reinsurance can provide a meaningful and unique return stream for portfolios, since natural catastrophes occur independently of economic cycles that tend to influence traditional asset returns.

#### Investor and Fed policy rate expectationst



Sources: U.S. Bank Asset Management Group Research, Bloomberg, September 29, 2025.

## Real asset markets

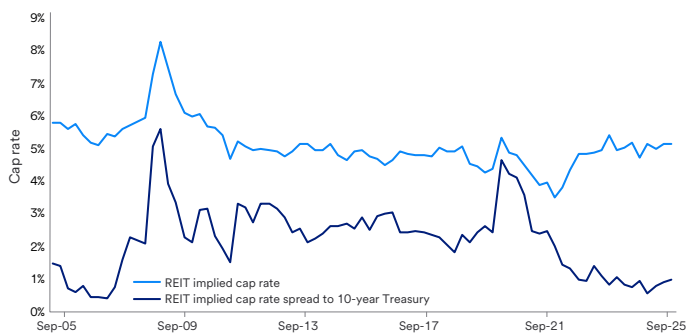
**Quick take:** Publicly traded real estate investment trust (REIT) prices rose modestly in the second quarter. Elevated Treasury yields keep developers' borrowing costs high while increasing competition for income-producing real estate, but investors expect relief via Fed rate cuts. Including REITs in portfolios can provide inflation protection through income that grows alongside economic activity.

- **Real estate reflects healthy fundamentals, except for office REITs, which remain stressed.** In recent quarters, publicly traded real estate has generated 2.7 to 3.0% annualized increases in net operating income, which measures property income less expenses. High occupancy rates persisted in the third quarter, holding above 93% across retail, apartment and industrial properties. Office real estate exhibits stress but accounts for less than 5% of broad REIT exposures. Office property income stagnated, and occupancy rates fell to multi-decade lows, hovering around 85%. Delinquency rates on commercial mortgage-backed securities rose in an orderly fashion; most delinquencies occurred in office real estate but aligned with analyst expectations.
- **Real estate can generate consistent portfolio income and should benefit from lower policy rates in coming quarters.** Real estate cap rates measure net operating income compared to property value and average around 5.1% for broad exposures, a compelling income opportunity. However, REIT cap rates exceed 10-year Treasury yields by just 1%, making valuations expensive relative to income opportunities in bonds. Despite elevated valuations, REITs offer the benefit that rental income and property prices can adjust higher as the economy expands, helping protect against sustained inflation and making REITs an important component of diversified portfolios.
- **We see current opportunities in global infrastructure, which includes a unique blend of for-profit entities that can grow earnings as broader prices rise, offering a potential hedge against rising inflation.** Global infrastructure exposures typically blend categories such as utilities, energy infrastructure such as oil and gas pipeline operators and transportation infrastructure companies. Utility performance lagged recently despite falling interest rates, but energy infrastructure and certain transportation infrastructure company prices rose. Global infrastructure stocks can help diversify portfolios, particularly during periods of high correlations between traditional stocks and bonds.

- **Commodities can help hedge portfolios against inflation, but volatile prices and divergence from broader consumer inflation rates are investment challenges.**

Performance varied significantly across commodity types in the third quarter. Prices rose on commodities typically viewed as safe havens, like precious metals. Gold prices surpassed most fundamental model price estimates supported by investor demand for a hedge against potential fiscal imbalances and U.S. budget sustainability concerns. Central bank buying drove a significant portion of gold demand in recent years, with a more recent boost from investor demand. Energy prices remain rangebound within a modest downtrend, amid moderating oil extraction costs and stale demands.

#### Income opportunities in REITs



Sources: U.S. Bank Asset Management Group Research, U.S. Treasury, Bloomberg; September 30, 2005-September 24, 2025. Cap rates derived from market cap weighted average cap rates for the largest REITs in SCHH.

## Alternative investments

**Quick take:** Hedge funds continue to deliver solid relative performance, with tariff headlines and interest rate speculation creating market opportunities. Investors use hedge funds to diversify their portfolios through complementary strategies. They are increasingly turning to alternative investments to balance their public security exposure, with hedge funds demonstrating lower correlation to equities in recent years while U.S. Treasuries have become more correlated with equity markets.

- **We find relative value strategies compelling amid ongoing macroeconomic uncertainty,** favoring managers who consistently demonstrate resilience across diverse market conditions. Unlike directional strategies that rely on market movements to generate returns, relative

value strategies seek profits by investing long and short in securities exhibiting pricing discrepancies with one another. Managers may choose to hold a similar number of long and short positions to make their portfolio market neutral or decide to own more long positions than short and maintain exposure to the overall market. This year, the most successful managers have positioned their portfolios to be net long or actively vary their net market exposure, capitalizing on the equity market rally and outperforming their market-neutral peers.

- **Rising macroeconomic and geopolitical risks are driving investor demand for multi-strategy funds** with flexible mandates that adapt to evolving opportunities. Investors are increasingly seeking to diversify beyond U.S. markets, making multi-strategy funds attractive for their geographic breadth and underlying strategy variety.
- **We maintain a positive outlook on event-driven strategies, which attempt to capitalize on major corporate, political or economic events.** Investors are showing renewed interest in merger arbitrage, or the purchase and sale of two merging companies at the same time, expecting a strong merger and acquisition cycle, and the deal pipeline appears robust through year-end. These strategies tend to move independently of overall market direction, which makes them particularly attractive during periods of heightened volatility.

## Private markets

**Quick take:** Investors and policymakers have recently accelerated the push to allow individual investors access to private investments. The trend of companies staying private longer means retail investors do not benefit from a newer company's early life rapid growth. Our thematic approach offers unique opportunities, since the new access-oriented investment products may not live up to their hype.

- **Investors often cite rising listing costs for companies staying private longer, but abundant private capital may be the real culprit.** Increasing direct and indirect public listing costs over the past 25 years deter mature private companies from entering public markets. Private company executives cite regulatory burdens, loss of control, increased scrutiny and exposure to frivolous lawsuits as key obstacles to going public. Additionally, the growth in available capital allows companies to fulfill their funding

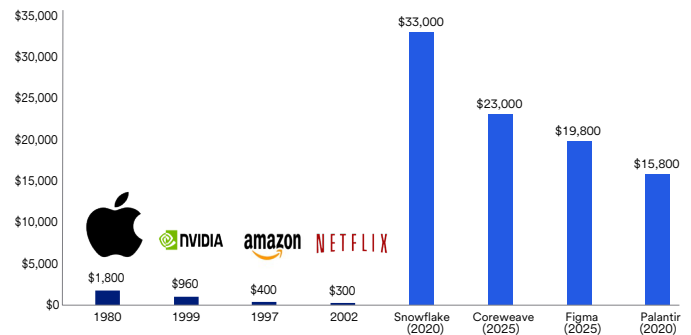


needs in private markets. President Trump directed the Department of Labor and the Securities and Exchange Commission to explore expanding access to private market investments for defined contribution retirement plans, such as 401(k) plans. Broader access for individual investors would add to the pool of private investment capital.

- **Multi-family residential real estate opportunities in underserved Midwest markets are attractive.** Our thematic work identifies Midwest market opportunities where stable demographics support demand amid limited new multifamily unit supply. Strong new supply over the next two to three years for the sunbelt and coastal markets is pressuring rents by approximately 2% year-over-year. In contrast, under-investment in the Midwest market means better affordability, with the lowest rent as a share of income nationally, according to Yardi Matrix 2024. Fragmentation of this region's multi-family unit ownership creates opportunities for seasoned investors to consolidate ownership and charge market rent prices after making value-add investments for property upgrades.
- **Private equity opportunities exist in defense and government technology.** As North Atlantic Treaty Organization countries ramp up defense spending to meet their stated 2% gross domestic product targets and subsequently scale that up to 5% of GDP by 2035, private equity will play an integral role in providing modern technology and infrastructure defense capability.

Additionally, Department of Government Efficiency (DOGE) spending cuts and federal workforce reductions necessitate technology investments to modernize government infrastructure. Given the long history of private equity investments in government technology, we see opportunities for investors to get involved in both the defense and government services sectors.

#### Valuation at IPO (millions)



Sources: U.S. Bank Asset Management Group Research, U.S. Treasury, Bloomberg; June 30, 2005-June 30, 2025. Cap rates derived from market cap weighted average cap rates for the largest REITs in SCHH.

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Diversification and asset allocation do not guarantee returns or protect against losses. Based on our strategic approach to creating diversified portfolios, guidelines are in place concerning the construction of portfolios and how investments should be allocated to specific asset classes based on client goals, objectives and tolerance for risk. Not all recommended asset classes will be suitable for every portfolio.



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**Equity securities** are subject to stock market fluctuations that occur in response to economic and business developments. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible difference in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** is subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investments in debt securities typically decrease in value when interest rates rise. The risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issuers of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes but may be subject to the federal alternative minimum tax (AMT), state and local taxes. There are special risks associated with investments in **real assets** such as commodities and real estate securities. For commodities, risks may include market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults). **Hedge funds** are speculative and involve a high degree of risk. An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem or transfer interests in a fund. **Private capital investment funds** are speculative and involve a higher degree of risk. These investments usually involve a substantially more complicated set of investment strategies than traditional investments in stocks or bonds, including the risks of using derivatives, leverage, and short sales, which can magnify potential losses or gains. Always refer to a Fund's most current offering documents for a more thorough discussion of risks and other specific characteristics associated with investing in private capital and impact investment funds. Reinsurance allocations made to **insurance-linked securities (ILS)** are financial instruments whose performance is determined by insurance loss events primarily driven by weather-related and other natural catastrophes (such as hurricanes and earthquakes). These events are typically low-frequency but high-severity occurrences. **Private equity investments** provide investors and funds the potential to invest directly into private companies or participate in buyouts of public companies that result in a delisting of the public equity. Investors considering an investment in private equity must be fully aware that these investments are illiquid by nature, typically represent a long-term binding commitment and are not readily marketable. The valuation procedures for these holdings are often subjective in nature. **Private debt investments** may be either direct or indirect and are subject to significant risks, including the possibility of default, limited liquidity and the infrequent availability of independent credit ratings for private companies.