



## Aptus Market Outlook: Q3 2025 Highlights

### Strong Earnings and Market Dispersion

Q3 extended the rebound that began after the April tariff scare, with equities pressing to repeated highs. However, this was not a rising tide. Mega caps advanced on real earnings strength tied to the AI CapEx cycle, while small caps rallied on hopes for rate cuts and valuation re-rating. The average stock lagged badly, a reminder that breadth has been narrow. Earnings remained the anchor with Q2 reporting showing 6% revenue growth and 13% earnings growth, one of the strongest seasons in years. Mega cap leaders continued to compound at an extraordinary pace, though the law of large numbers still points to eventual slowing. Importantly, operating margins remain firm, a constructive sign for equities.

### Reassessing Fixed Income: Duration Still at Risk?

Fixed income logged its third straight positive quarter, but the backdrop remains challenging. The Fed has shifted focus toward labor markets while inflation proves sticky. Core inflation remains above 3% and markets are not pricing a return below 2.7% during the current administration. The Fed itself does not project 2% inflation until 2028, implying 7+ years with inflation above target. With deficits near 6–7% and long rates unlikely to move much below 4%, the risk-reward for long duration looks shaky. Our stance continues to favor shorter duration, flexible tools, and diversifiers tied to volatility or real returns.

### Equity Market Themes: Breadth, Quality, and AI

Small caps outperformed large caps during Q3, yet the equal-weight S&P proxy gained only 4%, highlighting unusual dispersion. High beta has outperformed low beta by more than 50% since April, further proof that markets are rewarding certain exposures disproportionately. Mega caps continue to power higher, driven by CapEx in AI infrastructure. We do not see conditions resembling past bubbles as earnings and free cash flow fund much of today's growth, unlike the debt-fueled expansion of the late 1990s. For investors concerned about AI concentration, the key is to manage exposure at the allocation level, not chase specific winners.

### Policy Environment and Fiscal Realities

Fiscal math continues to dominate. Sustained deficits mean nominal growth must run hotter than in prior cycles, raising questions for both inflation and long rates. Recent GDP tracking by the Atlanta Fed is nearing 4% shows growth, complicating the Fed's cutting path. Goods disinflation has faded while services inflation remains sticky and tariff pass-through is slowly pushing prices higher. International equities, which outperformed earlier in 2025 on dollar weakness, have cooled as U.S. innovation and productivity advantages reassert. We maintain a



modest underweight to international, preferring U.S. small caps when seeking value discounts with stronger growth profiles.

### **Market Structure and Behavioral Tails**

Since 1942, 20% drawdowns have occurred about every five and a half years. This decade has already seen three. Right tails, however, occur just as often and compounding depends on capturing them. The S&P 500 is up more than 30% from April lows, marking one of the best five-month runs in history. Forward returns after such surges have historically been positive across 6–12 month horizons. We continue to stress that the path to higher compounded returns comes from thoughtful allocation, participation in upside, and hedging downside tails.

### **Outlook and Positioning**

We maintain rational optimism into year end and 2026. We own more equities than the average investor, favor quality and flexibility, and are intentional in fixed income. We maintain hedges that have a cost to hold but provide protection in left tail events and capitalize on these events to take on more risk when markets reset. The consumer remains strong, with assets nearly doubling over the last decade, versus a 46% rise in liabilities. That backdrop supports demand and underscores why compounding requires ownership of risk assets.

### **Disclosures**

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