



Financial Markets

Stocks, as measured by the S&P 500 Index, continued to make new highs in the third quarter. The Index added 8.1% during the period, bringing year-to-date gains to 14.8%. More impressively, the large-cap index has gained over 35% since its lows in early April when prospective tariffs by the Trump Administration spooked the market. Although some tariffs are in force, and additional levies may be forthcoming, investors have maintained their focus on continued corporate profit growth and elements of economic momentum. During the quarter, the Federal Reserve signaled and ultimately lowered interest rates, leading to growth-oriented companies driving stock returns. This includes the large technology companies that comprise an increasing portion of the S&P 500 as well as smaller-cap stocks. International stock markets also continued their rally, with year-to-date gains for both developed and emerging markets now above 25%.

Investors also grappled with the fact that the Fed is seeking to sustain economic activity while inflation remains elevated. Treasury bonds experienced a steepening of the yield curve, where shorter-maturity Treasury yields fell to account for the policy change, but longer-term interest rates moved only slightly lower due to concerns over sustained inflationary pressure. Such concerns were also likely the driving force behind the continued rise in gold prices, which increased 17% during the quarter and 48% so far this year.

Total Returns through September 30, 2025		
US Stocks	3 rd Quarter	Year-to-Date
Standard & Poor's 500	8.1%	14.8%
Russell 2000®	12.4%	10.4%
International Stocks		
MSCI World Ex-US	5.3%	25.3%
MSCI Emerging Markets	10.6%	27.5%
US Fixed Income		
Bloomberg Gov't/Credit	1.9%	5.9%
90-Day Treasury Bill	1.1%	3.2%

Investment Perspectives

The market's continued rise appears appropriate in the context of momentum in economic growth and corporate profits. However, such high-level readings of GDP expansion and aggregate earnings of the S&P 500 Index may belie more disconcerting emerging trends.

Second quarter GDP growth of 3.8% is high by most standards. However, this outsized growth is largely a function of reduced imports (which are subtracted in the GDP calculation), as businesses drew down inventories they had built up in the first quarter, ahead of tariff implementation. Although consumer spending has been resilient and investment in technological intellectual property and infrastructure has continued through the third quarter, cracks are beginning to show in the labor market — a primary pillar of the post-COVID economic expansion.

A Cooling Job Market Makes for a Challenging Situation

The last time a monthly job report showed job losses was in December 2020; however, several labor data releases over the past month have led economists and investors to question the job market's fortitude. In early September, the Bureau of Labor Statistics reported that the US had added only 22,000 jobs in August — a

weaker-than-expected, yet still positive, reading. However, the report also noted several revisions of past data, including lowering June's figures to a loss of 13,000 jobs for the month. Although some historical figures were revised upward, the aggregate of the revisions showed almost 1 million fewer jobs created in the year ending in March than the 2.35 million jobs previously reported; put another way, job growth averaged only 120,000 per month, rather than the far more robust 196,000 per month originally reported. Although still quite positive, such job creation may not be sufficient to accommodate the new entrants to the job market each month; however, for the time being, unemployment, at 4.3%, remains low by historical standards. More broadly, the updated data, as well as initial September reports that suggest possible job losses, undermine the notion that the labor market has seamlessly accommodated the Federal Reserve's inflation-fighting interest rate policy.

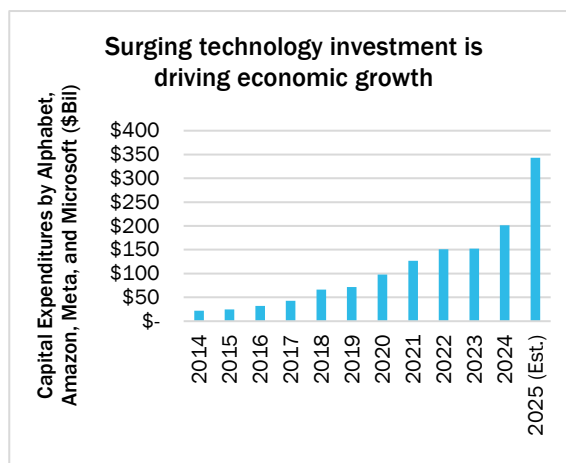
While the labor market weakens, inflationary pressure persists. The Commerce Department's most recent release of the Fed's preferred inflation tool, the Personal Consumption Expenditures (PCE) Price Index, showed that pricing pressures continued through August. With core inflation (i.e., excluding more volatile food and energy prices) at 2.9%, the same as it was in July, inflation remains stubbornly above the Fed's 2% target. Yet, despite slowing job gains and economic uncertainty, the same report showed that consumer spending has also maintained its momentum, with figures higher than analysts had been expecting.

The Fed, which has a dual mandate of full employment and stable prices, is tasked with managing these crosscurrents. The Fed governors themselves underscore the uncertainty of the moment with a wide range of forecasted policy rates in their internal survey of projections. Fed Chair Jerome Powell, following the Fed's September meeting at which the monetary policy committee lowered rates for the first time this year, summed up the conundrum well: "Near-term risks to inflation are tilted to the upside and risks to employment to the downside — a challenging situation." We agree.

Artificial Intelligence: Real or Hype?

One of the primary drivers of investor optimism has been the promise of Artificial Intelligence (AI). AI's potential to increase productivity (and thus economic output) is alluring to businesses and investors. For many users of ChatGPT and other generative AI tools, it is easy to imagine how broad applications of AI could improve efficiency and profitability in certain industries (e.g., call centers, search algorithms, advertising, etc.), but other applications are more dubious. Regardless of future returns, the investment spending related to AI infrastructure buildout has taken off, with the purchase or development of semiconductor chips, data centers, energy sources, and the required services to make it all work becoming a driver of the economy's expansion. In fact, technology spending, including the build-out of AI-related infrastructure, has accounted for half of economic growth this year.

Each quarter, corporate earnings releases seem to bring news of ever-larger capital expenditures in technology-related investments. Such spending is led by a small cohort of "Hyperscalers" that are building out massive cloud computing infrastructure and services for internal use and/or for other companies to leverage for their own applications. As the chart shows, just four companies are expected to account for well over \$300 billion in such spending this year as their investments continue to ramp sharply. That figure doesn't include other technology players scaling their infrastructure, as well as all the semiconductor, networking, equipment, and service businesses scrambling to meet the demand, which necessitates their own capital expenditures, perpetuating the investment cycle.



Conversely, some aspects of the AI story are beginning to feel more like hype, rather than rational development. A recent announcement by Oracle, another Hyperscaler, has raised eyebrows. Within its earnings release, Oracle revealed that its cloud services backlog (i.e., contracted future revenue) had increased by an incredible \$317 billion, with \$300 billion attributed¹ to a contract with OpenAI (the organization behind ChatGPT). The massive contract has attracted scrutiny of OpenAI, which currently generates only \$12 billion in annual revenue and thus requires external capital to finance its commitment. The privately-held company's March 2025 funding round valued the company at \$300 billion and secured \$40 billion in new funds. Its marketable value has risen to \$500 billion since then, but even additional capital raises are likely to leave the company well short of its future committed spending. Accordingly, the company is also counting on its partners/vendors, including Microsoft, Nvidia, and even Oracle, to help close the gap. Such circular financing is not entirely unique to this moment, but the result of all this AI hype may be increasingly speculative investments in the technology. At a minimum, such continued internal industry leverage increases downside risks if demand does not materialize as forecasted or is otherwise disrupted. Accordingly, we remain balanced in our view of AI: we are optimistic about the long-term productivity potential the technology may have for businesses and the broader economy, but also skeptical that all of today's spending will provide an attractive return on investment.

Outlook and Positioning

The economy and financial markets appear poised to continue their momentum in the final quarter of 2025, but underlying risks are accumulating. Wage increases have remained strong, albeit at a lower rate than in recent years, and have supported resilient consumer spending. Yet, lower-income consumers are challenged by still-elevated inflation, and thus the continuation of such spending is increasingly dependent on higher-income households. A similar phenomenon is at play in the broader economy, with the technology sector comprising a disproportionate share of investment and the economy's engine. Such concentrated dynamics contrast with broader-based spending, which generally allows for growth that is less susceptible to disruption.

Nonetheless, the strong tailwind from technology and AI-related spending has provided for a concentrated core of perceived beneficiaries to push the S&P 500 Index to an all-time high; the Index's aggregate valuation is also not far from its historical highs. We wrote about considerations related to the Index in [a recent blog post](#) on our website, so we won't rehash them here. That said, many stocks within the Index have not fully participated in the rally despite strong fundamental business results. We favor such companies that present sustainable business models and strong financial underpinnings, and so long as they sport reasonable valuations, these stocks can provide attractive returns over the long-term and through market cycles. Although interest rates have decreased, bonds continue to offer solid yields for multi-asset portfolios. Perhaps more importantly, high quality issues offer such portfolios ballast in a world with myriad sources of geopolitical tumult, domestic political skirmishes (and consequent shutdowns and/or reductions in government spending), and increasing risks to the US economy.

¹ Jin, B. (2025, September 10). Oracle, OpenAI sign \$300 billion cloud deal; among biggest in history. *The Wall Street Journal*. <https://www.wsj.com/business/openai-oracle-sign-300-billion-computing-deal-among-biggest-in-history-ff27c8fe>

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Sources: FactSet, Standard & Poor's, US Bureau of Labor Statistics, The Board of Governors of the Federal Reserve System, Federal Reserve Bank of Atlanta, US Commerce Department, Bureau of Economic Analysis

Chart Sources: Company Reports

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