3Q 2025

ECONOMIC OVERVIEW

Tariffs Take a Toll on Growth

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Review of 4Q 2024

The S&P 500 rose 8.23% in the third quarter of 2025 and is up 14.81% on a year-to-date basis. During the third quarter, the Trump administration continued to push new tariffs on the United States largest trading partners. Following the reciprocal tariff announcement in early April, during the third quarter they began to hammer out trade agreements. The administration reached permanent or temporary reduction agreements setting tariffs with China at 10%, Japan 15%, Vietnam 20%, Indonesia 19% and Mexico 25%. Tariffs continued to lead to volatility and uncertainty globally as GDP growth rates fell and core inflation rose. The on again off again tariffs and resulting trade flows have created volatility in the GDP growth numbers and have made the FOMC' s mission more difficult. The one offset is that through August 2025 the Treasury has collected $165.2 Billion in tariff proceeds, about two-thirds of which has been paid for by American consumers.

U.S. GDP Estimates

2024E	1Q 2025E	2Q 2025E	3Q 2025E	4Q 2025E	2025 Est.	2026 Est.	2027 Est.
2.7%	-0.6%	3.8%	2.5%	1.9%	2.0%	1.9%	2.1%

Source: Pinnacle Financial Partners

Rising trade barriers and policy uncertainty led to a global GDP slowdown during the quarter. GDP growth of developed economies remains below 2024 levels and is only projected to grow by 1.3% in 2025. Tariffs are driving geopolitical fragmentation and diverging trends with economies like China, where a real estate crisis is introducing deflationary pressures, and in the Eurozone, where weakened growth and slowing exports are having a deflationary effect.

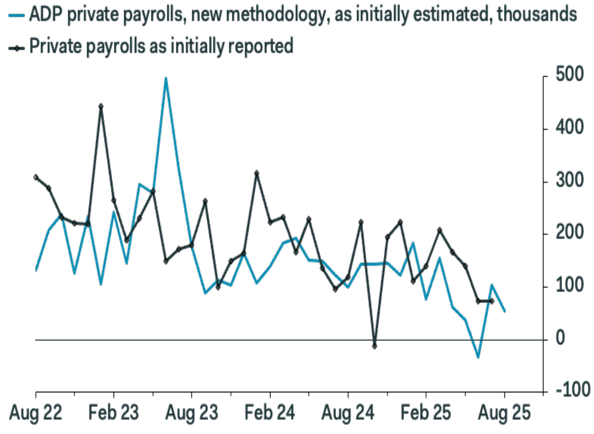
While the U.S. has fared better, we remain concerned that the Trump administration has over played the use of tariffs. The tariffs pulled forward GDP growth into the second quarter as consumers and businesses rushed to purchase automobiles and other capital equipment prior to the new tariff rates becoming effective. The volatility in the incoming economic data led the FOMC to tighten financial conditions as they paused their cuts in the Federal funds rate. A conflict then broke out between Israel and Iran, which will have regional repercussions in the future, including possibly higher oil prices that would be an added negative to consumers and the economy.

Economic Outlook

Our outlook for the balance of 2025 is positive. We are hopeful that the Trump administration moves past tariffs and focuses on strategically stimulating GDP growth. The administration continues to face ongoing legal challenges to his use of the emergency economic powers. and unilateral tariffs.

The passage of the One Big Beautiful Bill Act, which made permanent the 2017 tax cuts for individuals and corporations, is an important step in the right direction, and the bill added other positive features, like immediate expenses of capital goods, doubling of the standard deduction, and no taxation of tips and a deduction of $12.500 ($25,000 for joint filers) for overtime. We are hopeful that the Trump administration uses the tariff negotiations in the future to lower tariffs and trade barriers which would benefit everyone involved.

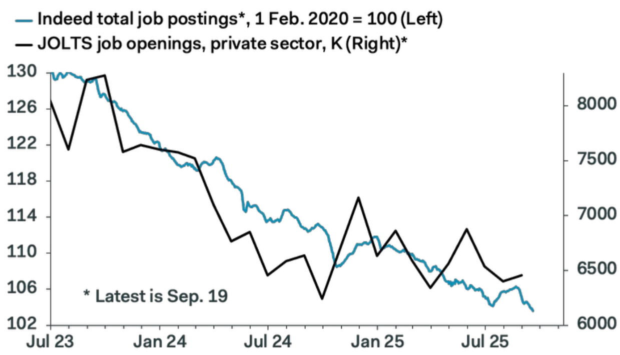
ADP and Private Payrolls



Source: Pantheon Economics

The labor market weakened substantially during the quarter with downward revisions in job growth data, increased layoffs and a contraction in the services and manufacturing sectors. This caused layoffs to increase 38% in 2025. The labor market is being buffeted by the tariffs, AI and automation, which has led to manufacturing employment being the lowest since 2008. The slowdown has adversely impacted job seekers as fewer job opening are available, and competition for openings has intensified. This has caused existing workers to remain with their employers longer and greater fear that if they lose their job, it will be difficult to get another one. The slowdown has caused increased unemployment rates for college graduates. All of this has meant that real consumption and consumer confidence continues to fall, which is one of the reasons we are not optimistic that GDP growth will rebound quickly.

Jolts and Indeed Job Postings



Source: Pantheon Economics

Retail sales are being held up by wealthier American's consumption, while low end consumers continue to see economic stress. Within the numbers many consumers have shifted their spending away from discretionary item toward household staples and essentials. We have seen negative trends in 3Q in furniture, building materials, general merchandise. As consumers shift toward value to maximize their dollars. Consumers continue to be buffeted by the higher cost of living, while inflation is a fact of life grocery prices are up 29% since the pandemic, this combined with the high shelter costs means we are very skeptical of a fast economic rebound driven by consumer spending growth.

The FOMC currently faces several challenges in achieving their mandate of full employment and stable prices. These include navigating high inflation, labor market weakness and structural economic changes driven by new trade and immigration policies. As we discussed last quarter, tariffs have the effect of lowering GDP growth and raising the inflation rate, and so far tariffs have led to an approximate 0.5% increase in Core PCE inflation. The crackdown on illegal immigration at the southern U.S. border, along with the ICE roundups, is limiting the supply of labor, which the FOMC fears could lead to wage growth even as the unemployment rate rises. Stagflation risks during the quarter have receded.

Unemployment Rate

'24 Act.	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25E	'26E
4.2%	4.2%	4.3%	4.4%	4.6%	4.5%	4.4%

Source: Pinnacle Financial Partners

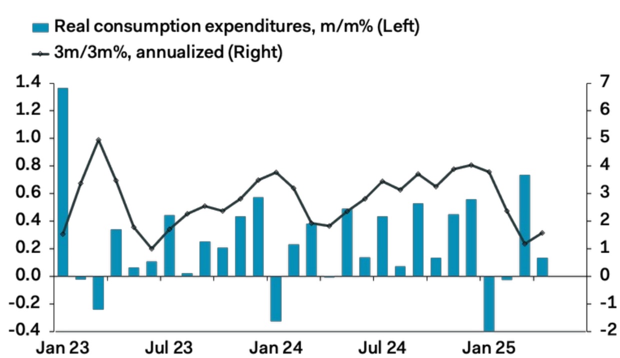
The U.S. budget deficit and funding of the U.S. government remain a challenge. In real terms, the deficit continues to slowly decrease. At quarter end, it stood just below 120% of GDP. Like the Biden administration, the Trump administration continues to only fund the U.S. Government for short periods of time. Any sustained government shutdown could further reduce our GDP estimates and lead to higher unemployment rates as government workers are furloughed or their pay is delayed. Estimates show that as many as 800,000 Federal government workers could be furloughed. The last President to truly reduce the size of government was Bill Clinton. Once the government reopens, we hope that the Trump administration uses the savings from the government staffing cuts and reductions in foreign aid to provide fiscal support for infrastructure, transportation, nuclear power generation development subsides and research and development, which should be beneficial to future growth.

The conflict between President Trump and Jay Powell has, we believe, caused the FOMC to become more hawkish in 2025 and made the committee more skeptical of the incoming economic data. We continue to fear that any additional creep in core inflation caused by the tariffs could mean that the FOMC will get behind the curve and risk the current economic recovery. We currently see the chance of a recession as 45%.

The Trump administration's rollout of tariffs has weakened U.S. growth. As we look into the fourth quarter and 2026, we believe that the administration needs to do no harm and focus on stimulating growth as the U.S. economy is experiencing an economic slowdown. While the tariffs were not helpful, one could argue that the onshoring of manufacturing will pay dividends in the future. We believe that the game the administration is playing of announcing new tariffs and then announcing exemptions for certain companies saps confidence for everyone and reduces overall confidence in the economy.

So far year to date the dollar has fallen approximately 10% versus other major currencies. We believe that the weaker dollar will provide additional growth in exports and be stimulative to future GDP growth. The dollar weakness will be a tailwind for U.S. company profitability. While there is no magic lever to solve our current economic slack, we believe that targeted fiscal support for infrastructure, R&D and tax incentives could be accretive to growth.

U.S. Real Consumption Expenditures

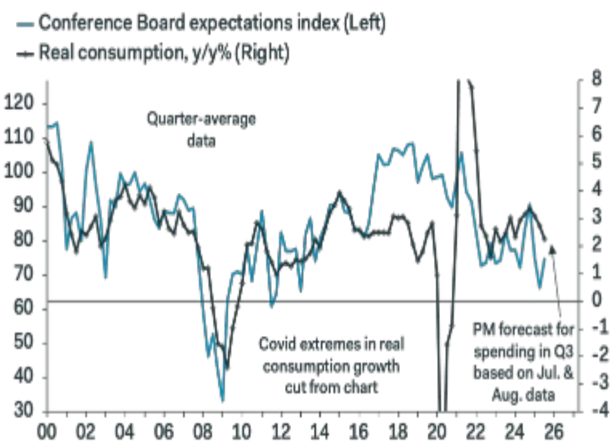


Source: Pantheon Economics

We expect the FOMC to cut the Federal Funds rate by a total of 0.75% in 2025, with 0.25% at both the October and December 2025 FOMC meetings. The government shutdown and the surrounding uncertainty and the threats of more government job losses has forced the FOMC to continue cutting rates. We also expect the FOMC to cut by an additional 0.50% in 2026. We see the neutral rate on Federal Funds to be around 3%. This would equate to a 6% prime rate. The volatility within the Treasury market has made predicting the number of FOMC cuts difficult, and at quarter end the Federal Funds Futures expect the FOMC to cut rates by 1.02 % by September of 2026. We believe these Federal Funds cuts are essential in order stimulate the U.S. economic growth, support the labor market and encourage borrowing and spending, which will assist the housing market and limit the damage occurring with the weakening labor market. Access to labor is necessary for higher GDP growth. The FOMC needs to look past current economic results and be accommodative because the expansion could be at risk if they do not continue to loosen financial conditions. We would like for the Trump administration to use the $200 billion in estimated tariff revenue as a reinvestment into the economy.

The artificial intelligence revolution will present challenges to the labor market, where many jobs will be replaced by AI and workers will have to be flexible and learn new skills to survive. AI will also continue to make inflation stickier than the FOMC would like by creating an insatiable demand for electricity. So far in 2025, wholesale electricity prices are up approx. 7%, while natural gas prices have risen by 18% so far in 2025. While AI will increase productivity in the U.S., it will also pose a challenge for the FOMC with higher inflation that affects both consumers and businesses. Consumer confidence continues to fall, with the September Conference Board data coming in below consensus at fifteen points below the last years pre-elections levels. Because of this, we see the unemployment rate remaining around 4.5% for the next two years as a recovery in the labor market will require much faster GDP growth which will not occur as long as tariffs are the administration focus.

Conference Board Expectation Index



Source: Pantheon Economics

U.S. Core PCE YOY

'23 Act.	'24E	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25E	'26E
2.9%	2.9%	2.7%	2.8%	2.9%	3.0%	2.7%	2.4%

Source: Pinnacle Financial Partners

Portfolio Strategy

At quarter end the S&P 500 traded at 24.3x earnings, up from 24.3x in the second quarter. The index is currently estimated to be trading at 22.04x 2026 earnings. While we raised our S&P 500 earnings projection last quarter due to optimism surround AI, current valuations are expensive by any measure. We expect 2026 S&P 500 earnings to grow by only 4%. This, combined with slow U.S. GDP growth, does not provide a very positive backdrop. The S&P 500 has experienced very strong annual return recently with the index up 26.29% in 2023 and 16.26% in 2024. We expect the index to close out 2025 up 15% or more.

The best performing sectors for the quarter were information technology up 14.48%, communications up 13.38% and consumer discretionary up 9.35%. The worst performing sectors for the quarter were consumer staples down 3.09%, real estate down 0.28% and Materials up 0.77%.

The best performing sectors year to date were communications up 24.52%, information technology up 22.31% and utilities up 17.69%. The worst performing sectors year to date were healthcare up 2.62%, real estate up 3.85% and consumer staples up 3.88%.

The S&P 500 sectors currently trading below the S&P 500 at the end of the third quarter were: energy 17.2x, financials 19.7x and utilities 20.2x. The most expensive sectors at quarter end were real estate 43.8x, information technology 42.8x and consumer discretionary 31.9x.