

## **Special Mid-Month Update – A Time to Reflect and Prepare**

by John E. Chapman

### **Overview**

Each year, September is traditionally a period of transition in the United States, with Labor Day marking the end of summer, the start of the academic year, and the arrival of fall, all of which contribute to changing routines and mindsets. The weather begins its annual shift from summer's warmth to cooler autumnal temperatures, and our days grow shorter as foliage begins to change color. Nature's transformation fosters an ideal time for reflection and planning.

As mentioned in my prior client letter, September has a reputation for being a challenging month for investors with increased market volatility and underperformance. Known as the "September Effect," there is a historical tendency for stocks to perform worse in September than in any other month, with the S&P 500 historically posting its poorest returns on average. September also precedes major fiscal deadlines, such as the U.S. federal budget cycle, which can introduce uncertainty and prompt cautious investment moves.

Following nearly three years of solid portfolio performance, we find ourselves in a moment of elevated valuations, increasing complacency, and portfolio strategies that have drifted in the direction of higher risk. Perhaps more this year than most, September presents investors with a particularly good checkpoint for portfolio review and strategic reassessment.

With two-thirds of the year now behind us, we would likely all agree that it has been a remarkable year of unexpected headlines and improbable developments. The dominant stories all connect to the transition to President Trump's second term in office, signifying an unprecedented flow of executive orders and major policy reversals. I originally noted that this would be a "transitional" year, only to recently shift into understanding that 2025 would be a "transformative" year. It's difficult to overstate the magnitude of change we are witnessing.

Through it all, this has been another notable year for investors – so far. As of the end of August, U.S. equities (as measured by the S&P 500) have enjoyed a total return of just over 10% with bonds (as measured by the Bloomberg U.S. Aggregate Bond Index) returning about 5%. A traditional 60/40 (Equity/Bond) balanced portfolio would have a year-to-date performance of about 8% in this period.

Technology has propelled stocks to perform better than value stocks, while large-cap sectors have continued to perform better than small-cap and mid-cap sectors. Marking a significant break from the trend of recent years, international equities have soundly outperformed U.S. stocks as the value of the U.S. dollar has been under pressure and investors have shifted allocations to areas representing more attractive relative valuations.

The S&P 500 is now selling at about 23 times forward earnings and stands at 1.6 standard deviations above its 30-year average. This is noteworthy as it suggests that the U.S. stock market valuations are

almost at their highest levels since the tech bubble. Within the S&P 500 Index, cyclical sectors are trading at about 19 times forward earnings, while technology sectors are trading as high as 29 times forward earnings.

It is reasonable to observe that those companies sitting near all-time highs must deliver exceptional future growth to justify current prices. Portfolio strategies that have become concentrated in the market's most expensive tech names could be quite vulnerable, should periods of elevated market stress emerge.

Most estimates of U.S. economic growth in 2025 now point to a full-year expectation of about 2%. While this level of activity has clearly allowed the economy to avoid a recession, this is not a particularly high level of activity. Resilient? Yes. Robust? Not quite. Making sense of the true level of economic activity can only be made more difficult with the various distortions lingering from the COVID shutdown and tariff-related swings in international trade and inventories.

### **It Is Not All Sunshine and Butterflies**

Current economic worries remain very high. Employment data has become quite volatile as significant downward revisions are announced, inflation continues to run above Fed targets, and the issue of the President's legal authority to initiate "reciprocal tariffs" is now moving to the courts.

With the Federal Court of Appeals upholding a lower court ruling that the President overstepped his legal authority on tariffs, the issue is likely to be appealed by the administration to the Supreme Court. We must be prepared for an extended period of ambiguity. It is entirely possible, even likely, that the Supreme Court will issue a temporary injunction leaving tariffs in place until they can take up the issue in full next spring. It is tough for businesses and investors alike to make long-term commitments with so much policy uncertainty.

While consumer spending has held up this year, weakness could develop if the labor market further deteriorates later this year. Nonfarm payrolls increased by only 22,000 in August, lagging the consensus expected 77,000. Worse, payroll gains for prior months were revised down by 21,000, meaning the net gain was only 1,000. Notably, June data now shows nonfarm payrolls dropped 13,000 following these revisions, the first decline since 2020 (First Trust).

On September 9th, the Labor Department's Bureau of Labor Statistics (BLS) announced revised job numbers that show a significantly weaker labor picture than earlier reports indicated. In fact, the U.S. economy added 911,000 fewer jobs over the 12 months that ended in March than originally reported. The report marked the largest preliminary revision on record, going back to 2000. Announcements such as this only add to concerns about the health of the economy and the state of BLS reporting, which has been under fire from the White House for its data collection methods and results.

As the third quarter winds down, attention will soon turn to the critically important holiday season for consumer spending. It is believed by some that many shoppers will be approaching the holidays with caution and practicality, adjusting their budgets and spending plans accordingly. In light of higher prices and a decline in the job market, consumers may scale back on discretionary purchases.

According to research conducted by McKinsey & Company, nearly half (46 percent) of U.S. consumers plan to keep their holiday spending in line with last year's levels, while roughly one in four intend to spend less. Economic pressures are disproportionately affecting lower-income households, who are less optimistic about the economy, further shaping holiday spending behaviors.

Inflation came in above expectations in August, with the Consumer Price Index increasing 0.4%, and the

year-ago comparison climbing to 2.9%. “Core” prices, which strip out food and energy, rose a consensus expected 0.3%, while the twelve-month core comparison stood pat at 3.1%. After surging in July, producer prices in August surprised investors by edging 0.1% lower versus an expected 0.3% monthly rise. “Core” producer prices year-over-year were up 2.8% for August 2025, which is lower than analyst expectations and down from last month’s 3.7%.

Of particular concern with consumer inflation is that it accelerated in the past three months - rising at an annual rate of 3.65%, the fastest three-month pace since January. The various cross-currents in data trends for inflation are problematic for the Fed and monetary policy. Perceived economic weakness argues for rate cuts, while sticky inflation suggests rate cuts are unwarranted.

We believe, as do most market commentators, the Fed will cut the Fed Funds rate by 0.25% at their September meeting, with a similar cut coming again in December. All eyes will be on the September 2025 FOMC meeting, which is scheduled for September 16 and 17. The Fed typically releases its policy statement at 2:00 p.m. Eastern Time on the second day of the meeting, followed by a press conference.

## **Implications for Investors**

On one side, the economy appears to be resilient. On the other hand, key economic indicators are flashing potential weakness. Corporate earnings have been quite good, government policies are decidedly pro-growth, and inflation appears to be heading in the right direction. Still, uncertainties are not receding with tariff policies now being adjudicated in the courts and critical labor market data experiencing significant revisions. Stocks appear to be priced for perfection. Still, stocks could quickly become vulnerable should the optimistic narrative turn negative.

The current environment is as challenging to navigate as any since the global pandemic. It is important for investors to remain disciplined with their strategies and understand the risks that have crept into the investment landscape. While it may be tempting to leave strategies on autopilot, investors must not become complacent.

Now is a good time to review risk levels, exposures, key objectives, and timelines. Investors would be well served to bring material changes to any of these factors to the attention of their advisors. Even as Clearwater Capital Partners regularly rebalances portfolios, good communication is a “best practice” when it comes to maintaining sound long-term strategies.

## **Conclusion**

September is often highly anticipated by sports fans for the start of the football season. For others, fall weather leads to different patterns of recreation and social engagement. For investors, we believe September is an ideal time to reflect on the progress made during the year, assess acceptable levels of risk, and look forward to next year, where the tail winds of increased corporate investment, regulatory reform, and lower borrowing costs could suggest continued economic expansion.

There is a lot to like about the resiliency we have seen in the U.S. economy. Against this backdrop, the equity markets continue to march higher - setting record highs after record highs. About the only thing not to like is the apparent consensus of optimism wherein investors appear unconcerned with high historical valuations and signs of speculative fervor. As is often said on Wall Street, when everyone begins to expect the same thing, something else typically happens.

We believe investors should maintain a long-term perspective while bracing for a potential increase in short-term volatility. The markets have come a long way; however, pullbacks are a normal part of market

rallies. As long as an investor's strategy is properly aligned to their risk tolerance level and planning horizon, short-term setbacks should be viewed as little more than buying opportunities for those wishing to invest additional capital.

As always, thank you for your continued confidence in our abilities to help you navigate the many challenges associated with growing and protecting your wealth.

**John E. Chapman**  
Chief Executive Officer  
Chief Investment Strategist



---

THIS COMMENTARY HAS BEEN PREPARED BY CLEARWATER CAPITAL PARTNERS. THE OPINIONS VOICED IN THIS MATERIAL ARE FOR GENERAL INFORMATION ONLY AND ARE NOT INTENDED TO PROVIDE OR BE CONSTRUED AS PROVIDING LEGAL, ACCOUNTING, OR SPECIFIC INVESTMENT ADVICE OR RECOMMENDATIONS FOR ANY INDIVIDUAL. ALL ECONOMIC DATA IS DERIVED FROM PUBLIC SOURCES BELIEVED TO BE RELIABLE. TO DETERMINE WHICH INVESTMENTS MAY BE APPROPRIATE FOR YOU, PLEASE CONSULT WITH US PRIOR TO INVESTING. INVESTING INVOLVES RISK WHICH MAY INCLUDE LOSS OF PRINCIPAL.

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities, insurance products, or to adopt any investment strategy. The opinions expressed are as of the date of writing and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by Clearwater Capital Partners to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Past performance is no guarantee of future results. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. Investment involves risks. International investing involves additional risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. Index performance is shown for illustrative purposes only. You cannot invest directly in an index. S&P 500 is a registered trademark of Standard & Poor's Financial Services, a division of S&P Global ("S&P"). DOW JONES, DJ, DJIA and DOW JONES INDUSTRIAL AVERAGE are registered trademarks of Dow Jones Trademark Holdings ("Dow Jones"). FTSE Russell® is a trading name of FTSE, Russell, FTSE Canada, FTSE FI, FTSE FI Europe, WOFE, RBSL, RL, and BR. "FTSE®", "Russell®", "FTSE Russell®", "FTSE4Good®", "ICB®", "Refinitiv", "Beyond Ratings®", "WMRTM", "FRTM" and all other trademarks and service marks used herein are trademarks and/or service marks owned or licensed by the applicable member of LSEG or their respective licensors and are owned, or used under license, by FTSE, Russell, FTSE Canada, FTSE FI, FTSE FI Europe, WOFE, RBSL, RL or BR. The two main risks related to fixed-income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments.