

Early-Cycle Transition: Balancing Risks and Opportunities Ahead



Exhibit 1: Trailing Returns as of September 30, 2025

| Index/ETF | 1-Mo | 3-Mo | YTD | 1-Y | 3-Y | 5-Y |
|--|-------|-------|-------|-------|-------|-------|
| Broad-based Emerging Markets (SPEM) | 5.4% | 9.5% | 23.6% | 16.7% | 18.1% | 8.2% |
| US Growth (SPYG) | 5.2% | 9.8% | 19.4% | 26.8% | 28.9% | 16.8% |
| US Large-Caps (SPY) | 3.6% | 8.1% | 14.7% | 17.5% | 24.8% | 16.4% |
| International Developed Equities (SPDW) | 2.5% | 5.7% | 27.5% | 17.5% | 21.9% | 11.1% |
| US Value (SPYV) | 1.7% | 6.2% | 9.6% | 6.8% | 19.5% | 15.3% |
| US Small-Caps (SPSM) | 1.0% | 9.2% | 4.4% | 3.6% | 12.7% | 12.9% |
| US Mid-Caps (SPMD) | 0.5% | 5.5% | 5.7% | 6.1% | 15.8% | 13.6% |
| Municipal Bonds (MUB) | 2.2% | 2.7% | 2.1% | 1.1% | 4.2% | 0.8% |
| Investment Grade Corporate Bonds (SPBO) | 1.7% | 2.7% | 7.1% | 3.9% | 7.4% | 0.5% |
| US Aggregate Bond Index (SPAB) | 1.1% | 2.0% | 6.2% | 2.9% | 4.9% | -0.5% |
| High Yield Credit (JNK) | 1.0% | 2.4% | 7.3% | 7.1% | 10.8% | 4.7% |
| US Treasury 7-10 Year (IEF) | 0.7% | 1.7% | 7.0% | 2.1% | 3.5% | -2.3% |
| Treasury Inflation Protected Notes (SPIP) | 0.5% | 2.1% | 6.9% | 3.5% | 4.7% | 1.1% |
| Silver (SLV) | 17.1% | 29.1% | 60.9% | 49.2% | 34.3% | 14.4% |
| Gold (GLD) | 11.8% | 16.6% | 46.8% | 46.3% | 32.0% | 15.0% |
| Broad-based Commodities (BCI) | 2.3% | 3.7% | 9.1% | 8.9% | 2.5% | 11.0% |
| Crude Oil (USO) | -1.5% | 0.9% | -2.4% | 5.5% | 4.1% | 21.1% |

Source: FactSet. Data as of September 30, 2025. 1Y, 3Y, and 5Y numbers are annualized.

Equity Strength in Q3 Shows Signs of Broadening

Despite inflation concerns and revealed weakness in the labor market, equities rallied in Q3 with market participation broadening amid improving trade policy, rate cut optimism, and better than feared corporate earnings. Both the Nasdaq Composite Index and S&P 500 Index notched their best Q3 since 2020, as well as their best September in 15 years despite the month's poor seasonality. For the quarter, US growth (+9.8%) was among the best performers, followed by emerging markets (+9.5%) and US small-caps (+9.2%). Bonds fared well as munis rose 2.7%, investment grade corporates gained 2.7%, and high yield credits increased 2.4%. Commodities produced positive returns as silver was up 29.1%, gold rose 16.6%, broad-based commodities increased 3.7%, and crude oil gained 0.9%.

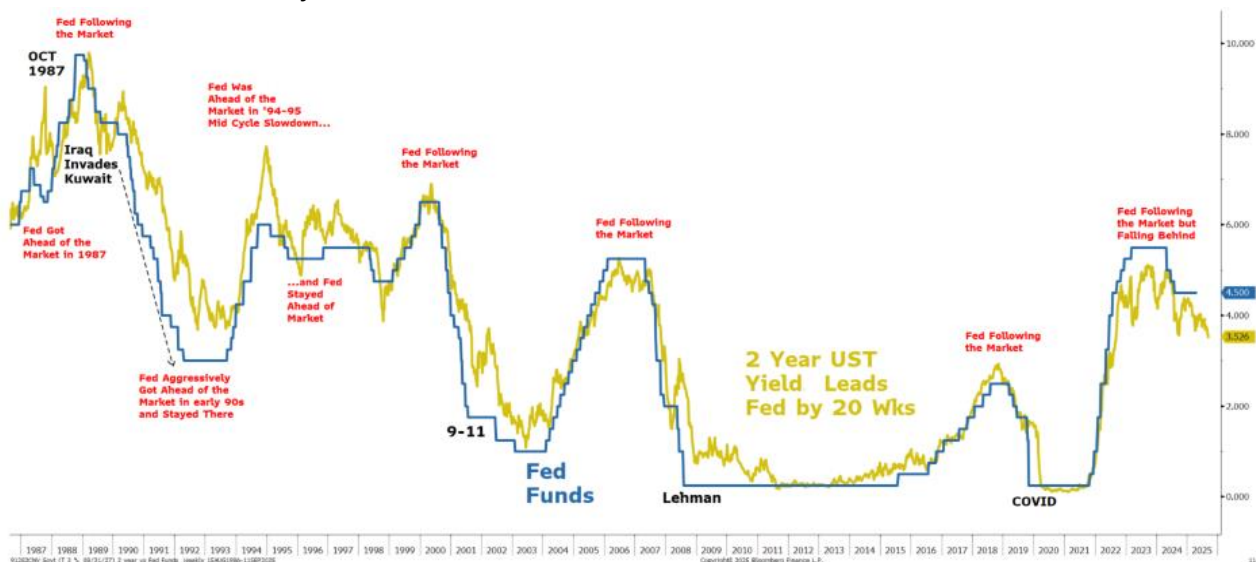
Fed Rate Cuts Return as Labor Market Softens

The Federal Reserve cut the fed funds rate by 25 bps at the September FOMC meeting, lowering the target range to 4.00–4.25% and resuming an easing cycle that began last year. Chair Powell acknowledged softer labor market conditions, stating that “revised jobs numbers mean the labor market is no longer solid” and that low hiring has become “a growing concern over the last few months.” Governor Stephen Miran, a recently appointed Fed governor and former Treasury official, was the lone dissenter in favor of a deeper 50 bp cut, echoing market calls for bolder action. The updated Summary of Economic Projections (SEP) showed inflation via the Core Personal Consumption Expenditures (PCE) price index remaining above target for 2025 at 3.1%, while GDP growth for the year was revised up to 1.6% from the June projection of 1.4%. Revised figures also indicated roughly 50 bps of additional cuts through year-end, with further reductions into 2026–27. However, officials emphasized that the pace of easing will depend on incoming data, as the simultaneous expected rise in both inflation and unemployment complicates future decisions. In his speech last week at the 2025 Economic Outlook Luncheon, Powell also noted that equity prices are “fairly highly valued,” cautioning that the path of rate cuts may be shallower than what markets currently anticipate.

Fed Behind the Curve?

The 2-year Treasury yield continues to lead the Fed funds rate, highlighting officials' reluctance to ease meaningfully until inflation moves lower. At the same time, goods inflation is now rising rapidly and the steady decline in services inflation has stalled at elevated levels, likely on the back of tariffs. With markets pricing in more cuts than the Fed may deliver, will there be a pullback in equities if expectations are repriced? Or will rising unemployment sway the Fed to adhere to the market's forecast?

Exhibit 2: 2-Year Treasury Yield vs. Fed Funds

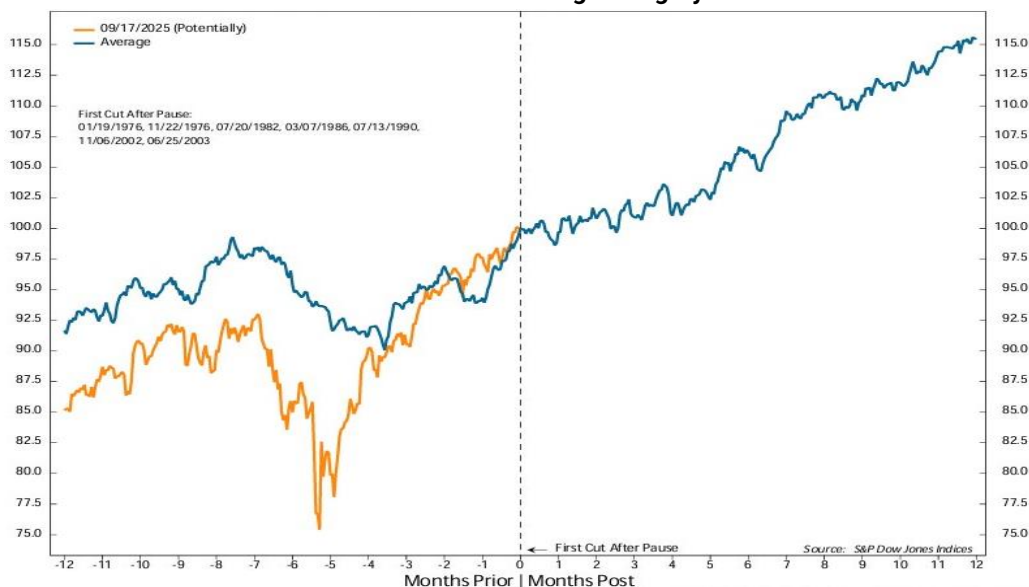


Source: Morgan Stanley Research, Bloomberg Finance L.P. Data as of September 11, 2025.

Performance Around First Rate Cut After a Pause

When examining equity performance following at least a 6-month pause in past Fed cutting cycles, history shows that the S&P 500, on average, has tended to rally meaningfully over the subsequent 12 months. Current market performance (orange) was weaker than the historical average in the earlier months leading up to the September cut, but will equities follow their historical pattern in the post-cut period?

Exhibit 3: S&P 500 Index Around First Cut Following Easing Cycle Pauses of ≥ 6 Months



Source: Ned Davis Research, Inc. S&P Dow Jones Indices.

Potential Shift Ahead for Market-Cap Weight vs. Equal Weight

The S&P 500 Equal Weight index tends to lag when mega-caps lead, but has historically outperformed its market-cap weighted counterpart when leadership broadens. The market-cap weighted version has dominated the equal weight index for much of the past five years and is currently on its best streak since the late 1990s. However, history suggests this trend is likely to end, a shift that could be further supported by the recent dovish turn in monetary policy. Moreover, during the burst of the Dot Com Bubble, equal weight held up meaningfully better than the cap-weighted S&P as the former was less concentrated in overvalued mega-cap technology companies.

Exhibit 4: Dot Com Crash: 3/24/00- 7/23/02 (%)



Source: Bespoke Investment Group

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We recognize the economy is showing hallmarks of a late-cycle environment, yet early-cycle signals are beginning to emerge alongside a more dovish monetary policy outlook. Fundamentals are constructive in areas such as banks, small and mid-cap equities, while the earnings growth gap between the largest technology names and the broader market is expected to narrow in the near term. Still, challenges persist, with a softening labor market, sticky inflation risks, and policy uncertainty from tariffs creating a more complex backdrop. Importantly, the data does not appear recessionary: earnings revisions have recovered meaningfully, corporate results have exceeded expectations, and both manufacturing and services PMIs remain near or above expansionary thresholds. Viewed together, these dynamics stress the importance of staying focused on the bigger picture, as markets remain forward-looking even amid near-term crosscurrents.

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