

A Rising Tide: Third Quarter Market Review and Outlook

October 14, 2025

Key Takeaways

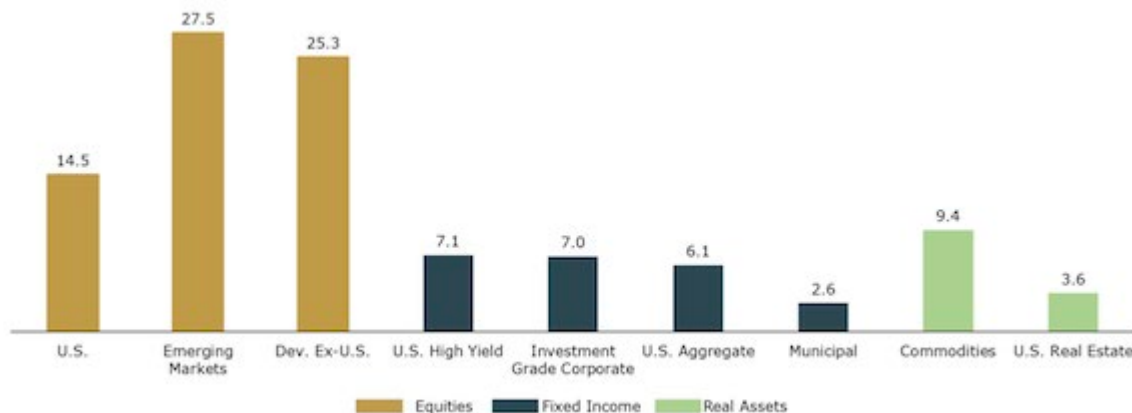
- The broad U.S. stock market climbed to new highs fueled by strong corporate earnings, especially among technology companies. Broad-based gains pushed all S&P 500 sectors into positive territory for the year-to-date period.
- The bond market rallied as well, buoyed by a dip in interest rates across maturities.
- The U.S. economy continued to show resilience despite lingering inflation and trade uncertainty. While the job market is weakening, unemployment remains low by historical standards.

For much of this year, uncertainty around trade, fiscal and monetary policy ran high. In the third quarter, however, investors got answers to some key policy questions with the passage of President Trump’s One Big Beautiful Bill Act and the Federal Reserve’s resumption of the rate-cutting cycle it paused nearly a year ago.

They also got welcome news on corporate earnings, which helped ease (but not erase) worries about the impact of historically high tariffs. The S&P 500 index posted [strong earnings growth](#), beating analysts’ expectations by a healthy margin. The index marked its ninth consecutive quarter of positive earnings.

Earnings growth, greater policy clarity and other tailwinds drove U.S. stocks to new highs. The third quarter marked the first quarter this year the U.S. stock market outperformed international equities markets, which have been buoyed by a sharp decline in the value of the dollar. Read on for a closer look at third-quarter trends and our take on the near-term outlook.

2025 Year-to-Date Returns, % change



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Note: views are from a U.S. dollar perspective. Data labels represent total year-to-date returns. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. Source: Kestra Investment Management with data from FactSet. Index proxies: Bloomberg U.S. AGG Bond Index, ICE BofA U.S. Corporate, ICE BofA U.S. High Yield, Bloomberg Municipal Bond, S&P 500, MSCI EM, MSCI World ex US Index, Dow Jones U.S. Select REIT, and Bloomberg Commodity Index. Data as of September 30, 2025.

The AI Effect

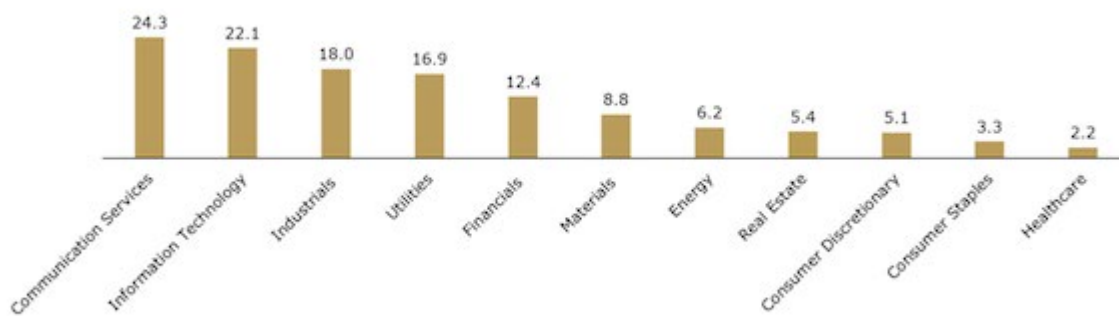
The Technology sector, which tumbled in the first quarter and has been climbing back since then, rallied after reporting strong earnings. The sector's robust earnings growth accounted for nearly 60% of the S&P 500's total earnings growth.

Continued strong demand for artificial intelligence (AI) and massive capital investments have been a tailwind for earnings in the Tech sector and beyond. Some of the biggest names in Tech and Communications Services are [collectively spending](#) hundreds of billions to build out and expand their AI infrastructure over the next year.

Behind Technology and Communications Services, Industrials has been the third best-performing sector for the year, and that's no coincidence. Massive investments in data centers, fiber-optic networks and other AI-related infrastructure have begun to flow through to the sector and lift earnings, helping to offset the pain of higher materials prices, labor shortages and other headwinds.

All in all, every sector fared relatively well for the quarter. Even Consumer Discretionary and Healthcare, which were in negative territory at the end of the second quarter, saw positive returns.

U.S. Equity Sectors, 2025 Year-to-Date Returns, % change



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Economic Resilience and a Yellow Flag

As reflected in the equities market, the U.S. economy has remained resilient this year despite policy uncertainty, sticky inflation and other headwinds. Gross domestic product (GDP) is expected to grow by 3.8%, according to the Atlanta Fed's latest [GDPNow forecast](#).

That said, the all-important job market has been showing signs of strain. Job growth has trended downward in recent months, and small business hiring continues to slow. The unemployment rate (still low by historical standards) ticked up to 4.3% in August.

Why is job growth slowing even as the economy continues to grow? More-restrictive federal immigration policy, which is shrinking the labor pool, may be one factor. Cuts to the federal workforce and AI-driven productivity gains may also be contributing to the slowdown.

Either way, the weakening job market prompted the Fed in September to resume its rate-cutting cycle, after pausing for nearly a year because of sticky inflation and the potential inflationary effects of higher tariffs. The central bank cut its benchmark rate by a quarter of a percentage point last month and is expected to lower it by another half point by the end of the year, assuming the labor market doesn't show signs of improvement.

We're keeping a close eye on the condition of labor market, which some have described as "low hire, low fire." While layoffs have risen over the last several years, we haven't seen the kind of spike that typically ushers in a recession. In fact, layoffs remain at low levels by historical standards, which gives us some comfort in the underlying strength of the job market.

Tax Cuts and Other Tailwinds

We also believe that continued investment in AI should help to underpin economic growth. By one estimate, between \$3 trillion and \$4 trillion will be spent on AI infrastructure by the end of decade. ([Watch this edition of Money with Murphy](#) for a deeper dive into the promise and challenges surrounding AI.)

In addition, we have yet to see the full economic impact of the One Big Beautiful Bill Act (OBBBA). The bill includes some complex and potentially controversial elements, such as its impact on the deficit and government spending. But it also contains a range of incentives to support U.S. businesses, including tax provisions aimed at encouraging companies to build new factories and increase spending on heavy equipment. ([Watch this edition of Money with Murphy](#) to learn more about what's in the OBBBA.)

Of course, the path forward won't be without challenges. Trade uncertainty continues to loom large, including on-again, off-again [skirmishes over tariffs](#) between United States and China. What's more, the U.S. is once again in the midst of a government shutdown, which can have [wide ranging implications](#) for the economy and the markets.

Still, periods of uncertainty often give way to opportunity, as we've seen this year. As always, staying the course, especially when markets are unsettled, remains one of the most-reliable ways to reach your long-term financial goals.

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