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Investment Insights Monthly

From the Desk of Jack Kraft, CFA, Investment Strategist

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September Insights: Balancing Valuations, Fed Cuts and AI Investment

September started off with volatility as the markets grappled with historically poor seasonality on one hand and continued artificial intelligence (AI) optimism on the other. The S&P 500 is up more than 30% from April lows and has notched several fresh all-time highs this month since dipping on the first day of September. Investors have cheered on weak labor market data as reasons for the U.S. Federal Reserve (Fed) to ease monetary policy, while earnings and AI investment remain strong.

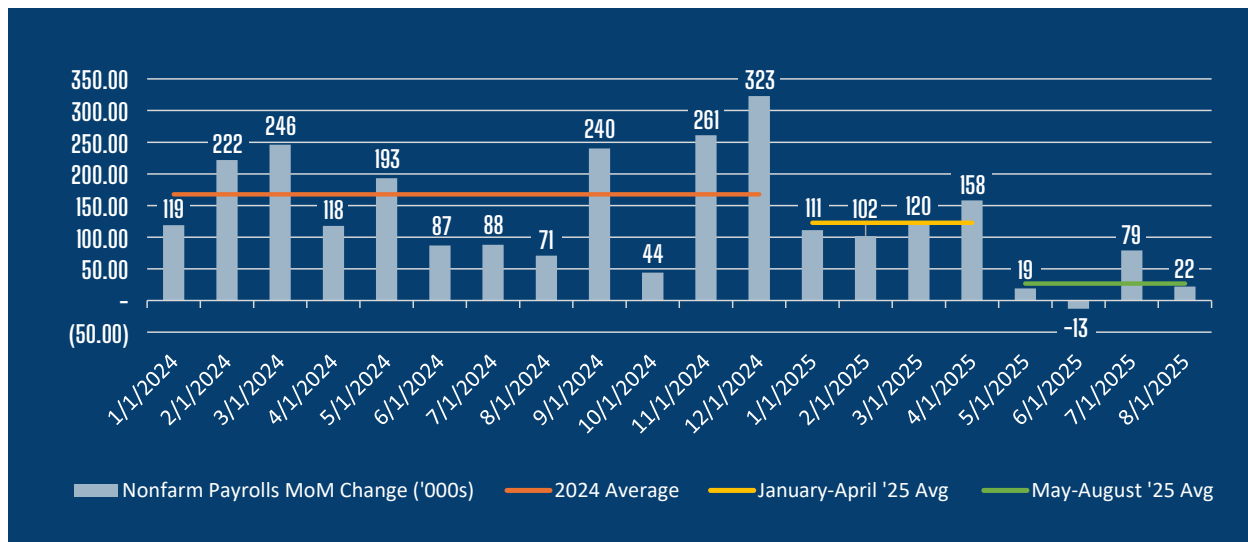
Economic data has been closely watched by U.S. central bank leaders as they attempt to navigate policy back to neutral without reigniting inflation and avoiding

a recession. Currently, the market is pricing in five 25-basis-point (bps) interest-rate cuts by the end of 2026. Don't hold your breath though—things can change quickly, and will look different when President Trump replaces Fed Chair Powell at the end of his term in May 2026 with a central bank leader that likely leans more dovish. Tariff-induced inflation remains a key risk, and the Fed is watching this closely as it tries to navigate a soft landing for the economy. The term coined by investors is a “Goldilocks” scenario, which the Fed is looking to deliver—a neutral benchmark rate without dragging the economy into a recession.



The Fed is considering its “dual mandate” when making interest-rate policy decisions. They want to balance inflation and the labor market, while remaining data-dependent by looking at economic releases each month. On the economic growth front, growth has remained resilient, with the Atlanta Fed estimating real gross domestic product growth in the third quarter of 3.0%. Meanwhile, inflation has remained elevated and above the Fed’s 2.0% average goal, but well below the peak of 9.0% in 2022. A reading on the Producer Price Index came in below expectations for August, helping offset a high print in the prior month. Meanwhile, the Consumer Price Index rose in line with expectations to 2.9% annualized. On the labor market front, a concerning 22,000 nonfarm payroll jobs were added in the month of August; that was the fourth consecutive discouraging monthly report. Additionally, the unemployment rate ticked up to 4.3%, while the most recent read on initial jobless claims jumped to the highest level in almost four years.

Decline in Job Growth (Nonfarm Payrolls in 1,000s)



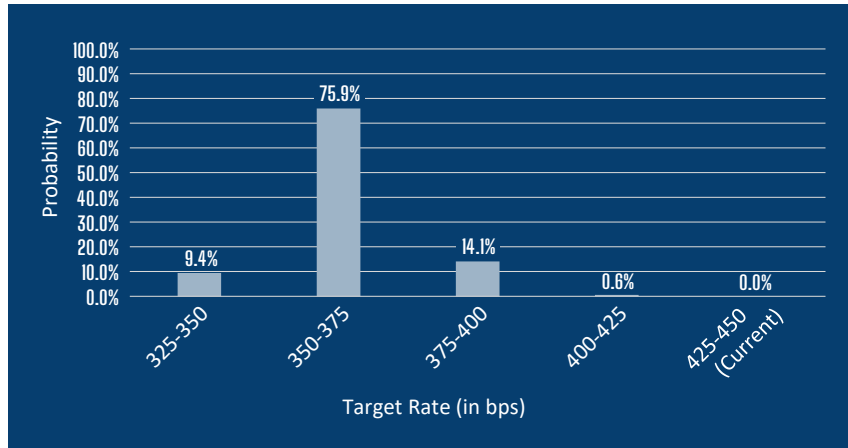
As of August 31, 2025
Source: Ycharts, Bespoke Investment Group

Labor market weakness overtook inflation concerns at the latest Federal Open Market Committee (FOMC) meeting, prompting the Fed to initiate its first rate cut in nine months. This move signals a shift toward a more neutral policy stance, though the Fed remains modestly restrictive. According to CME Group’s FedWatch Tool,* the market is now pricing in two additional 25 bps cuts at the October and December Fed meetings, which would put the target rate at 3.50–3.75% to end 2025. This would mark only the ninth time in history since 1994 that the Fed cut rates following the S&P 500 hitting an all-time high less than 10 days prior to the meeting. According to Bespoke Investment Group, one year after cuts in this scenario, the market was higher each of the nine times. Although history is never a predictor of future returns, it is important to remember the coined phrase by mutual fund manager Martin Zweig: “Don’t fight the Fed.”

*The CME FedWatch Tool analyzes the probability of FOMC rate moves for upcoming meetings. Using 30-Day Fed Fund futures pricing data, which have long been relied upon to express the market’s views on the likelihood of changes in U.S. monetary policy, the tool visualizes both current and historical probabilities of various FOMC rate change outcomes for a given meeting date.



Target Rate Probability for December 2025 Fed Meeting



As of August 31, 2025
Source: CME Group FedWatch Tool

36% in a day and saw a rise in market cap similar to the size of Disney, propelling the company to be on the verge of joining the \$1 trillion market-cap club.

Market sentiment remains overly bullish, with the path of least resistance being to the upside amid the AI revolution and the easing of monetary policy on the horizon. This bullish setup has pushed equity valuations to much higher than average levels and, as a consequence, has stalled corporate share buyback growth. According to Goldman Sachs, S&P 500 companies repurchased shares at a record pace in the first half of 2025, as many companies took advantage of the tariff-induced market volatility. However, in the second half of 2025, buybacks slowed down as mega-cap stocks have focused more on investments in capital expenditures rather than returning cash to shareholders via stock buybacks. In fact, the S&P 500 buyback yield is expected to decline to 2.0% from 2.5% last year.

Although dollars spent on buybacks in 2025 are expected to grow roughly 5% to \$1.0 trillion in 2025, the effect on earnings per share has been impacted as valuations have expanded. This happens when market capitalization grows faster than corporate profits. A research report from Goldman Sachs on S&P 500 buybacks is calling for a rebound in share repurchase growth next year as earnings-per-share growth remains strong and uncertainty surrounding Fed and trade policy decline, boosting willingness for corporate buybacks.

All in all, the market seems to be humming on all cylinders in 2025 as corporate profits last quarter proved to be able to absorb tariff increases. Elsewhere, investment in AI continues to expand as mega-cap tech competes for the best next-generation technology. To quantify this investment, the combined capital expenditures budget of five hyperscalers (Oracle, Microsoft, Alphabet [Google's parent company], Meta and Amazon) has climbed dramatically from \$154 billion in 2023, to \$239 billion in 2024, to \$368 billion in 2025, and is projected to reach \$432 billion by 2026, underscoring the intensifying race to lead in next-generation AI technologies.

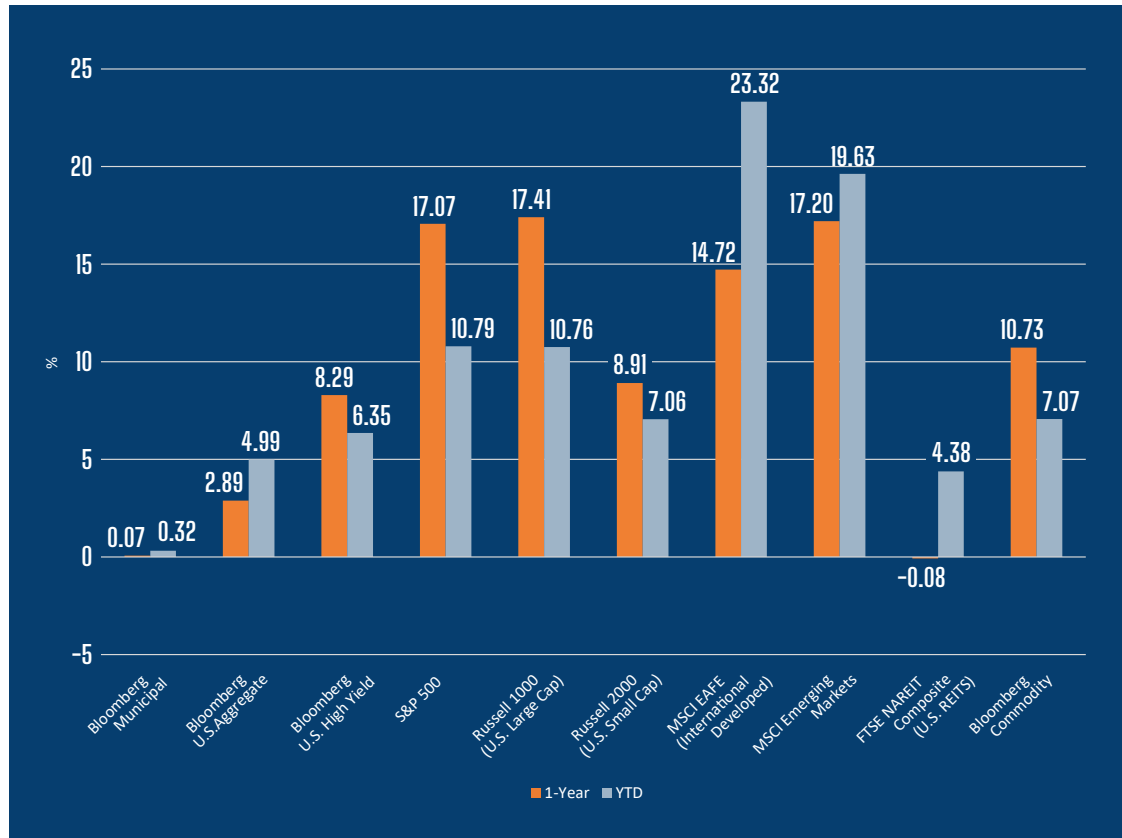
There's no denying that the overall market is trading at lofty valuations, which has been the case for most of this year. That alone doesn't mean the market has to move lower from here, because investors have shown willingness to pay up in order to participate in the AI revolution with hopes that stocks can grow into current multiples. However, investors should be aware that a slowdown in AI investment poses the risk of valuation compression in names connected to this theme. Rebalance accordingly and remember to manage risk tolerance as investments grow.

Moving the S&P 500 higher this month can be attributed to the AI trade following second-quarter earnings. The most recent development has been updated guidance from Oracle's cloud business that sparked a broad rally in AI-related stocks. Oracle guided for a 14-times increase in its cloud infrastructure segment over the next five years, which would increase revenues from \$18 billion in 2026 to \$144 billion by the end of 2030. This reassured markets that a slowdown in capital expenditures spending isn't on the horizon in the short term. Everything related to AI rallied, from data centers and semiconductors to infrastructure stocks. Oracle shares rallied



Asset Class Returns

Comparing Recent 1-Year and Year-to-Date Total Returns



As of August 31, 2025

Source: Conway Investment Research

Fixed Income

- Interest rates remained volatile throughout August but ultimately trended lower, providing a nice boost to core fixed income and municipal bonds.
- Credit spreads tightened in August, fueling solid gains in high yield, loans and emerging-market debt.
- U.S. dollar weakness once again added to returns across non-U.S. assets.

Equities

- U.S. equities gained ground in August, led by small caps and value stocks.
- Small caps outperformed large caps by almost 500 bps last month, and value beat growth across all market capitalizations.
- Year-to-date, large caps continue to rule the day, but it has been a fairly solid year for all styles and capitalizations.
- Stocks outside the United States posted solid gains last month, driven by developed markets, the weaker U.S. dollar and small caps.
- Similar to what occurred in the United States, small caps beat large caps, and value stocks trounced growth stocks.
- Emerging markets lagged Europe, Australasia and Far East (EAFE) markets, largely due to weakness in Europe and Asia Ex China. China and Latin America outperformed.
- U.S. dollar weakness added 216 bps to EAFE returns and 9 bps to emerging-market returns.



August 29, 2025	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.38%	0.75%	2.90%	4.62%	4.83%	2.97%	2.04%
Bloomberg Municipal	0.87%	0.67%	0.32%	0.07%	2.54%	0.40%	2.18%
Bloomberg US Govt/Credit Intermediate	0.00%	0.86%	3.80%	4.64%	4.17%	1.71%	1.93%
Bloomberg U.S. Aggregate	1.20%	0.93%	4.99%	2.89%	2.89%	-0.63%	1.79%
Bloomberg U.S. High Yield	1.25%	1.71%	6.35%	8.29%	8.90%	5.17%	5.81%
Bloomberg Global Aggregate	1.45%	-0.06%	7.21%	3.38%	3.25%	-1.72%	1.11%
U.S. Equity Indices							
DJ Industrial Average	3.42%	3.59%	8.30%	12.13%	14.61%	11.88%	13.04%
S&P 500	2.03%	4.32%	10.79%	17.07%	18.79%	14.70%	14.50%
NASDAQ Composite (Price)	1.58%	5.33%	11.11%	22.49%	21.31%	12.90%	16.08%
Russell 1000	2.10%	4.37%	10.76%	17.41%	18.57%	14.33%	14.23%
Russell 1000 Growth	1.12%	4.94%	11.33%	23.97%	24.23%	15.39%	17.78%
Russell 1000 Value	3.19%	3.78%	10.01%	10.28%	12.20%	12.79%	10.16%
Russell Mid Cap	2.50%	4.40%	9.45%	13.38%	12.91%	11.90%	10.79%
Russell 2500	5.25%	7.28%	7.75%	10.74%	10.55%	10.95%	9.78%
Russell 2000	7.14%	9.00%	7.06%	8.91%	9.52%	9.90%	8.85%
Russell 2000 Growth	5.91%	7.72%	7.20%	11.33%	10.83%	6.98%	8.65%
Russell 2000 Value	8.47%	10.39%	6.90%	6.46%	8.06%	12.68%	8.65%
Non-U.S. Equity Indices							
MSCI World	2.64%	3.98%	14.12%	17.12%	18.44%	13.41%	12.14%
MSCI ACWI	2.51%	3.93%	14.67%	17.23%	17.69%	12.46%	11.58%
MSCI ACWI Ex-U.S.	3.54%	3.27%	22.19%	16.49%	15.57%	9.36%	7.80%
MSCI EAFE	4.27%	2.82%	23.31%	14.72%	17.45%	10.70%	7.86%
MSCI EAFE Growth	2.82%	-0.27%	15.91%	6.06%	13.15%	6.33%	7.53%
MSCI EAFE Value	5.74%	6.03%	30.97%	23.91%	21.87%	15.01%	7.93%
MSCI Europe	3.45%	1.63%	25.71%	14.07%	18.78%	11.65%	8.03%
MSCI Japan	6.96%	5.46%	18.07%	14.03%	16.79%	9.08%	7.48%
MSCI AC Asia	3.20%	4.48%	18.89%	18.12%	13.72%	6.38%	7.61%
MSCI EAFE Small Cap	4.64%	4.57%	26.87%	20.05%	14.99%	8.57%	7.81%
MSCI ACWI Ex-U.S. Small Cap	4.29%	4.50%	23.36%	18.17%	14.66%	9.79%	8.27%
MSCI Emerging Markets	1.47%	3.51%	19.63%	18.20%	11.48%	5.31%	7.34%
MSCI EM Asia	0.96%	3.53%	18.27%	18.63%	11.98%	4.67%	8.24%
MSCI China	4.94%	10.01%	29.23%	49.90%	10.11%	-2.10%	5.67%
MSCI EM Eastern Europe	-0.14%	0.76%	51.75%	38.34%	38.48%	-11.93%	-2.07%
MSCI EM Latin America	8.30%	3.51%	34.79%	13.83%	9.22%	10.79%	6.44%
MSCI EM Small Cap	2.69%	3.41%	14.78%	11.30%	13.94%	12.13%	8.63%
MSCI Frontier Markets	6.31%	13.62%	36.67%	35.92%	14.98%	11.06%	7.13%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	1.60%	2.32%	5.96%	8.26%	8.03%	3.95%	3.54%
Real Assets Indices							
FTSE NAREIT Composite	3.42%	2.42%	4.38%	-0.08%	2.73%	6.11%	6.60%
Alerian MLP	-0.58%	2.57%	9.81%	15.46%	19.37%	28.93%	6.71%
Bloomberg Commodity	1.93%	1.46%	7.07%	10.73%	-1.86%	10.36%	3.56%
S&P Global Infrastructure	1.97%	2.13%	17.94%	20.31%	11.66%	12.42%	8.39%
Other							
Oil Price Brent Crude	-6.08%	0.75%	-7.75%	-12.80%	-13.45%	8.62%	3.13%
CBOE Market Volatility (VIX)	-8.13%	-8.19%	-11.47%	-1.85%	-16.31%	-7.73%	-5.14%

Source: Morningstar



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