PLAINSCAPITAL BANK

MARKET HIGHLIGHTS

Market Commentary
September 2025

By Andrew Cunningham, CFA, CMT, ChFC

Executive Summary

- Inflationistas see tariff-induced inflation as the most urgent risk to the economy and the market.
- Deflationistas view labor weakness as the greater risk and see price increases from tariffs as a temporary shock that the central bank should overlook.
- Regarding growth, consensus is expecting a tariff-induced growth slowdown, while the recently reported data is surprising to the upside.
- Regarding inflation, while the consensus is concerned about inflation, the actual inflation surprise is occurring to the downside.
- The resulting mix of steady and possibly increasing growth, along with stable inflation that might even have some downside, provides a powerful tailwind for stocks and profit margins.
- Similarly, the gap between consumer expectations that stocks will rise or fall reached a peak of pessimism in April and has since steadily rebounded. Historically, this signals a more optimistic outlook for the stock market.
- Analyst earnings revisions have been optimistic, with more upward than downward adjustments, and expectations for quarterly earnings keep improving—another positive sign.
- Monetary policy and fiscal policy are tailwinds to stock markets.
- Consensus predicts a repeat of Q4 2024, when the Fed cut rates and bond yields rose.
- The 10Y UST yield continues to fall, and sovereign bond markets of other G5 nations sell off.
- If the US faces a growth scare, support on the short end at the 2Y UST is expected to be around 3.25%, and on the long end, with the 10Y UST, around 3.9%.
- Credit risk is unattractively priced as investment-grade spreads are at three-decade lows of about 70 bps.
- Because of the expected persistent high inflation, deglobalization, and fewer price-sensitive buyers of UST issuance, and increasingly positive correlation for stock and bond returns, we remain cautious about significantly increasing duration as a long-term allocation.

Dedicated Investment Team

Andrew Cunningham, CFA®, CMT®, ChFC®
Chief Investment Officer
512.457.7534 | andrew.cunningham@plainscapital.com
Central Texas

Stephen Schaller, CFA®, CFP®
Market Manager, Portfolio Manager
713.749.8113 | stephen.schaller@plainscapital.com
Houston/ Coastal Bend

Jerrod Dawson, CFA®
Manager of Investment Strategies and Portfolio Management
214.252.4150 | jerrod.dawson@plainscapital.com
Dallas

Victor Tanguma, AIF®
Senior Portfolio Manager
956.661.5466 | victor.tanguma@plainscapital.com
McAllen/ Rio Grande Valley

Larry Smith
Senior Portfolio Manager
806.791.7256 | larry.smith@plainscapital.com
West Texas

Irene Silva, AWMA ®
Portfolio Manager
817.258.3818 | irene.silva@plainscapital.com
Fort Worth

Kendall Parker
Manager of Investment Services
214.252.4165 | Kendall.parker@plainscapital.com
Dallas

Triana Ramon
Analyst
214.252.4166 | triana.ramon@plainscapital.com
Dallas

Morgan Cook
Analyst
817.258.3705 | morgan.cook@plainscapital.com
Fort Worth

Markets at a Glance:

Equity - TR (%)	1M	3M	YTD	1Y
RUSSELL 2000 INDEX	3.3	12.5	10.2	11.6
NASDAQ COMPOSITE	4.4	11.7	17.0	24.5
MSCI EM	5.7	10.4	27.9	18.7
MSCI EM LATIN AMERICA	7.2	10.3	41.8	17.8
MSCI AC ASIA PACIFIC	3.9	9.3	23.9	16.6
S&P 500 INDEX	2.9	8.5	14.0	17.1
MSCI WORLD	1.9	7.1	16.3	16.4
DOW JONES INDUS. AVG	2.0	7.0	10.1	11.5
MSCI WORLD x USA	1.2	4.6	24.9	14.1
MSCI EAFE	0.3	4.2	23.7	13.5
S&P500 EQUAL WEIGHTED IX	-0.4	4.0	8.1	6.6
Sectors - TR (%)	**1M**	**3M**	**YTD**	**1Y**
Communications	7.2	15.2	25.7	38.6
Information Technology	5.3	12.9	20.7	26.0
Consumer Discretionary	2.4	10.6	5.3	19.9
Energy	5.1	8.2	10.3	10.8
Utilities	2.5	7.7	17.1	12.2
Industrials	-0.1	5.3	16.9	14.8
Financials	0.7	4.4	12.7	21.4
Real Estate	0.6	3.2	5.5	-1.8
Materials	-2.8	2.2	8.2	-6.0
Healthcare	-0.7	1.5	-0.1	-9.9
Consumer Staples	-1.6	-1.6	3.5	0.2
Alternatives - TR (%)	**1M**	**3M**	**YTD**	**1Y**
FTSE NAREIT All Eq REITS	0.9	3.0	3.8	-3.7
S&P LISTED PRIV EQUITY	-2.5	2.4	4.6	7.8
BBG Galaxy Bitcoin Index	-1.7	1.5	16.9	68.3
ALERIAN MLP INDEX	-1.0	0.2	7.3	13.7
LS Managed Futures Index	0.4	0.0	-1.0	-1.4

Data source: Bloomberg

US Style Returns (%) - Russell Indices

1M

	Value	Core	Growth
Large	1.5	2.8	4.0
Mid	0.9	-0.2	0.6
Small	2.6	3.3	4.1

YTD

	Value	Core	Growth
Large	11.3	13.9	16.2
Mid	8.9	8.8	12.9
Small	9.0	10.2	11.3

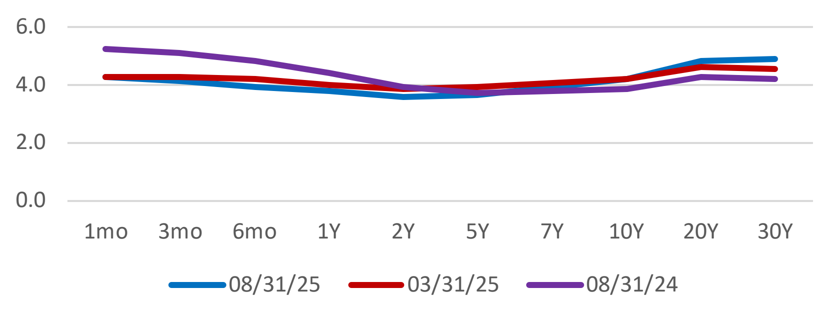
US Factor Returns (%)	1M	3M	YTD	1Y
S&P 500 High Beta	3.6	12.5	23.3	22.1
MSCI Value	5.2	11.6	20.4	17.9
MSCI Growth	4.1	11.2	16.6	26.5
MSCI Momentum	3.9	6.5	18.3	19.3
MSCI Quality	2.2	6.4	10.4	9.7
MSCI Size	1.0	5.2	9.4	9.9
MSCI High Dividend Yield	0.1	4.9	9.0	5.1

Commodities TR (%)	1M	3M	YTD	1Y
Silver	19.3	24.8	52.6	38.4
Gold	10.8	13.0	43.3	40.7
WTI Oil	4.6	5.9	-4.1	-0.5
BBG Commodities Index	3.8	2.5	6.4	5.2
Sugar	-3.6	0.2	-5.8	-16.0
Wheat	-2.3	-7.1	-13.2	-19.5
Copper	5.3	-8.0	15.1	1.2
Natural Gas	2.4	-21.1	-17.9	-10.6

Data source: Bloomberg

Index Characteristics	FWD ERP	P/E TTM	P/S TTM	Div Yield
S&P 500	2.7%	27.5	3.3	1.2
MSCI EAFE	4.9%	16.5	1.6	3.0
MSCI EM	5.7%	16.2	1.6	2.5

US Treasury Yield Curve



Fixed Income - TR (%)	1M	3M	YTD	1Y
10 - 20 Yrs	2.1	3.9	9.1	3.5
Municipal Bond Index	2.4	3.1	2.6	1.4
U.S. Corporate High Yield	0.8	2.7	7.1	7.5
Corporate	1.1	2.6	6.5	3.4
US Agg 1-7 Yrs.	0.4	1.3	5.3	4.0
1-3 Yr	0.3	1.1	4.0	4.0

Interest Rates (%)	08/31/25	06/30/25	03/31/25	08/31/24
US Fed Funds Effective Rate	4.33	4.33	4.33	5.33
US Generic Govt 1 Mth	4.31	4.21	4.30	5.26
US Generic Govt 3 Mth	4.14	4.29	4.29	5.11
US Generic Govt 12 Mth	3.83	3.97	4.02	4.40
US Generic Govt 5 Yr	3.70	3.80	3.95	3.70
US Generic Govt 10 Yr	4.23	4.23	4.21	3.90
BBG Tax Muni AGG YW	5.21	5.26	5.23	4.96
BBG UA Corporate YW	4.91	4.99	5.15	4.94
BBG U.S. Corp HY YW	6.75	7.06	7.73	7.30

Data source: Bloomberg

Equity Highlights

A debate has persisted in markets and among economists since 2008 between the ‘deflationistas’ and the ‘inflationistas.’ The deflationistas worry about long-term economic structural challenges from disinflationary technological advances, coupled with an aging population. In contrast, the inflationistas fear the effects of inflation caused by monetary and fiscal expansion. We view the debate as more of a seesaw, with cyclical forces allowing either side to be correct, depending on current conditions and the data's suggestion about the cyclical outlook.

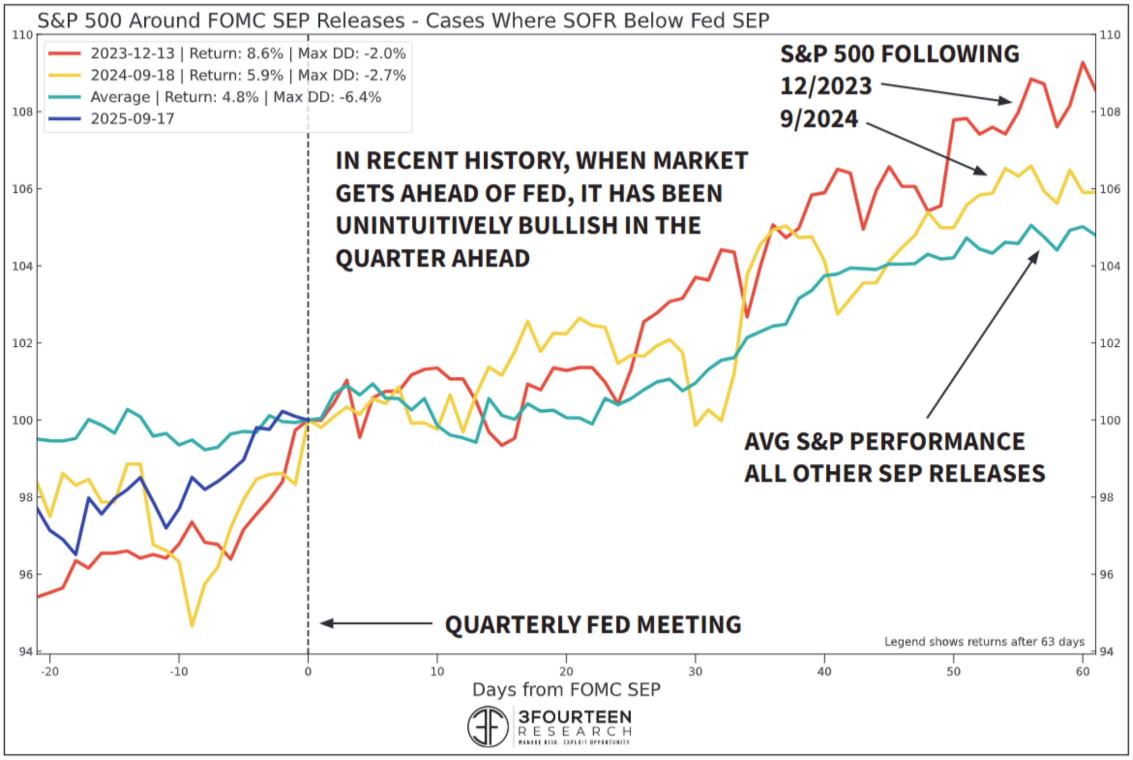
Today, the old saying “The more things change, the more they stay the same” remains as relevant as ever. Currently, inflationistas see tariff-induced inflation as the most urgent risk to the economy, bond yields, and, consequently, the market. This group also appears to believe that the economy is healthy and reaccelerating. In the opposing camp, the deflationistas view labor weakness as the greater risk and see price increases from tariffs as a temporary, one-time shock that the central bank should overlook. Data suggests that, although there is a risk of higher inflation in goods, it is being offset by disinflation in housing and rent. Regarding labor market uncertainty, immigration continues to complicate matters. Last year, a surge in immigration raised concerns about the unemployment rate; today, the reversal of immigration is likely to suppress the unemployment rate. Monitoring recent data and jobs reports, the evidence continues to favor the deflationistas. While poor job reports and rising unemployment increase recession risks, proactive rate cuts, deregulation, and record fiscal stimulus are expected to start impacting the economy in Q1 2026, reducing recession risks. We view the economy's trajectory as U-shaped, with the US economic position roughly at the bottom of the ‘U’. This view aligns closely with the Fed’s Statement of Economic Projections (SEP), as Jay Powell noted at the September 17th post-FOMC press conference.

“You can think of this in a way as a risk management cut, because if you look at the SEP, actually the projections for growth this year of next actually ticked up just a little bit, and inflation and unemployment didn’t really move a lot.”

As expected, the Fed lowered rates by 25 basis points. Before the meeting, the spread between the Fed’s 2026 rate projections and the SOFR market widened to its most significant point since September 2024. In other words, the market has gotten too far ahead of reality in predicting rate cuts. This has also been a consistent theme over the past twelve months. Paradoxically, this has actually been more bullish for stocks lately.

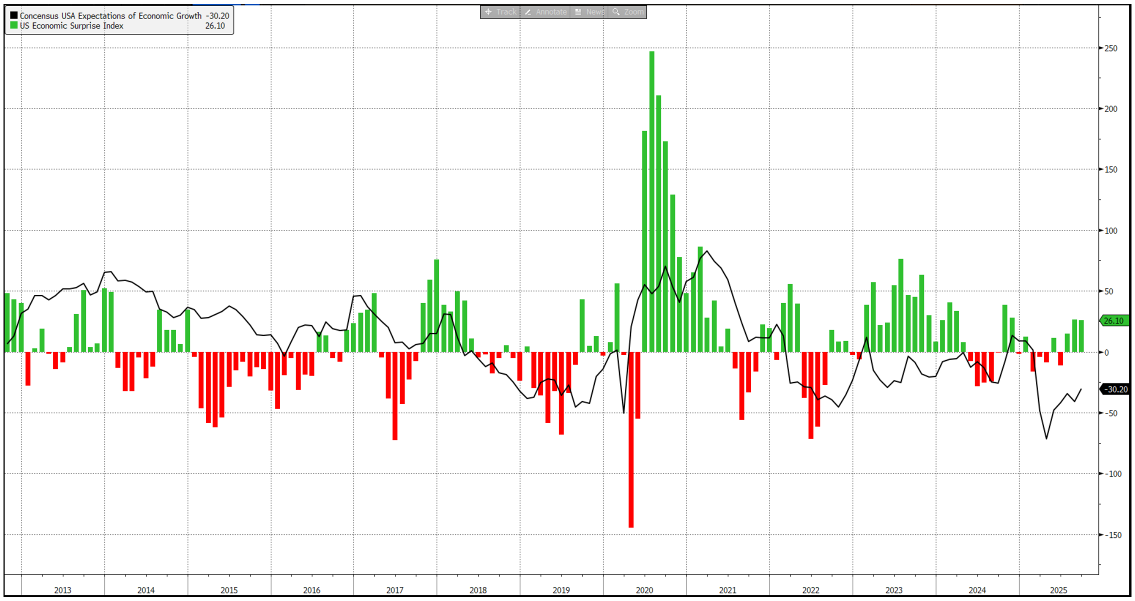
Critical points for the equity markets:

- Inflationistas see tariff-induced inflation as the highest risk to the economy and the market.
- Deflationistas view labor weakness as the greater risk and see price increases from tariffs as a temporary shock that the central bank should overlook.
- Regarding growth, consensus is expecting a tariff-induced growth slowdown, while the data is surprising to the upside.
- Regarding inflation, while the consensus is concerned about inflation, the actual inflation surprise is occurring to the downside.
- The resulting mix of steady and possibly increasing growth, along with stable inflation that might even have some downside, provides a powerful tailwind for stocks and profit margins.
- Similarly, the gap between consumer expectations that stocks will rise or fall reached a peak of pessimism in April and has since steadily rebounded. Historically, this indicates a more optimistic outlook for the stock market..
- Analyst earnings revisions have been optimistic, with more upward than downward adjustments, and expectations for quarterly earnings continue to improve—another positive sign.
- Monetary policy and fiscal policy are tailwinds to stock markets.



This is somewhat confusing. If rates stay higher for longer and expectations are disappointed, shouldn't that be bearish? Recent market history suggests that when the market outpaces the Fed, it has been bullish for the next quarter in terms of stock returns. Examining the dot plot and SEP, the median forecast indicates higher inflation and lower unemployment, with three possible rate cuts. In short, real rates are declining. The recent performance of safe-haven assets, such as gold and bitcoin, front-ran the FOMC policy action. Additionally, uncertainty around growth, inflation, and policy projections remains high. This aligns with Powell's mention of "a risk management cut." The Fed signals that downside risks outweigh upside risks and is hesitant to sacrifice employment in favor of price stability.

The overall economic sentiment and forecast, indicated by the black line in the chart below, appears negative. Concerns about "souring" economic growth data and a tariff-induced slowdown have been a concern all year. However, we remain uncertain about how negative our outlook on the economy should be. The Surprise data for economic growth, shown by the green and red bars in the chart, has turned positive. This highlights an apparent disconnect between how investors feel about the economy and the actual economic conditions.



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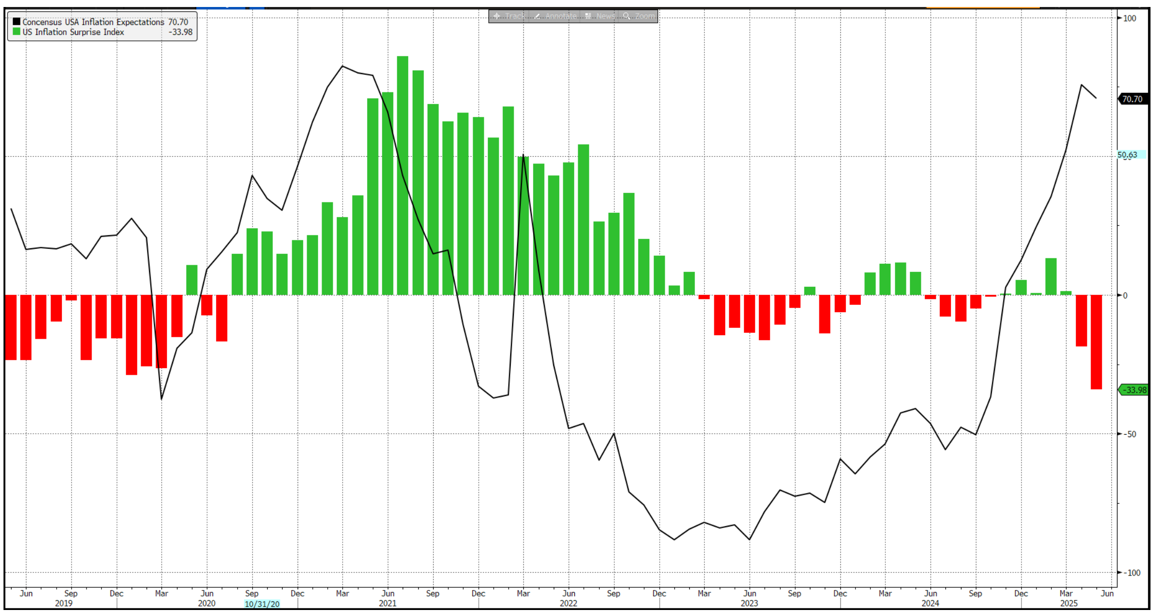
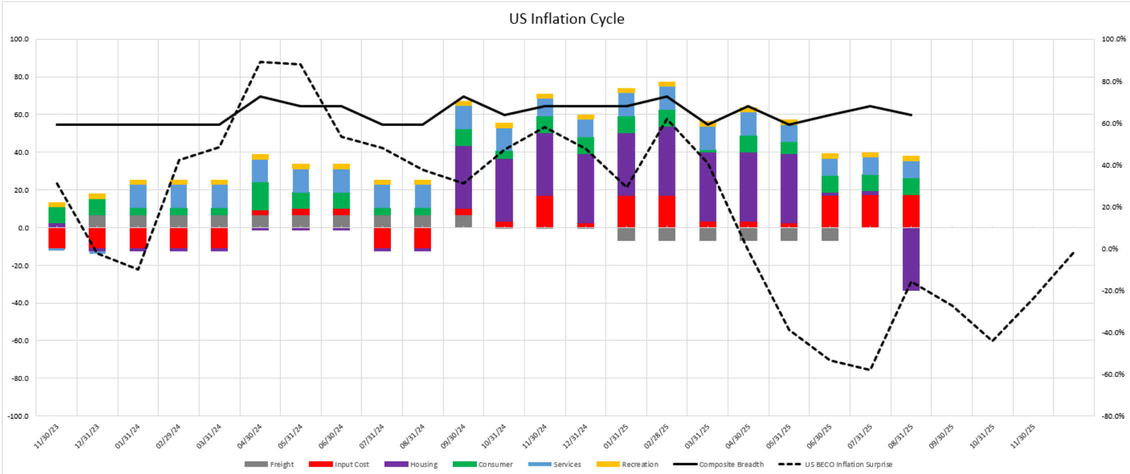
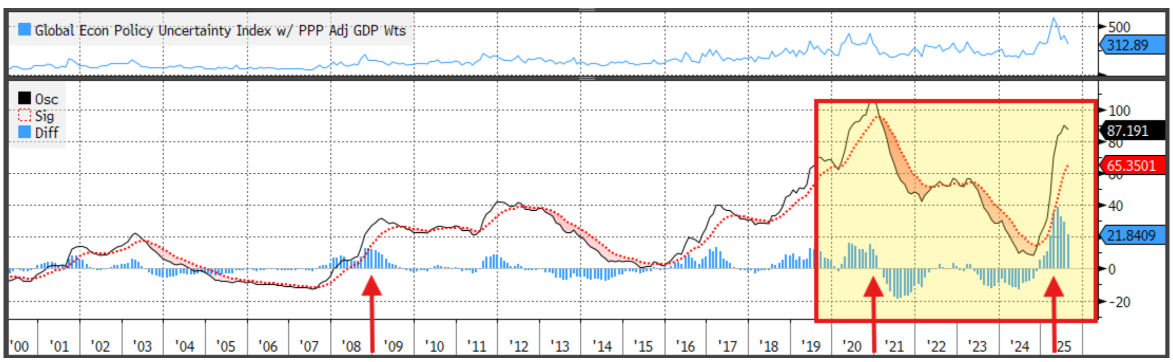


Housing and rents, which account for ~33% of the weight in the CPI headline index, are weighing on reported CPI inflation, while goods and services are keeping inflation sticky at 3%.

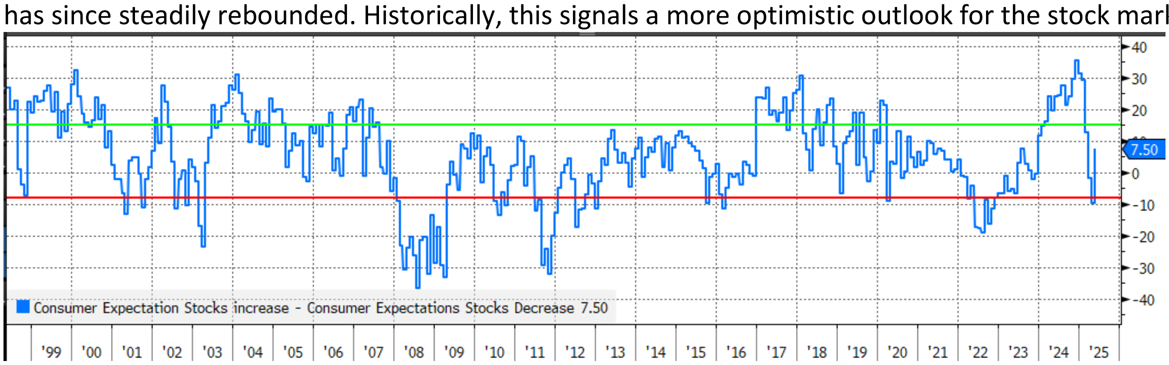


The resulting mix of steady and possibly increasing growth, along with stable inflation that might even have some downside, provides a powerful tailwind for stocks and profit margins.

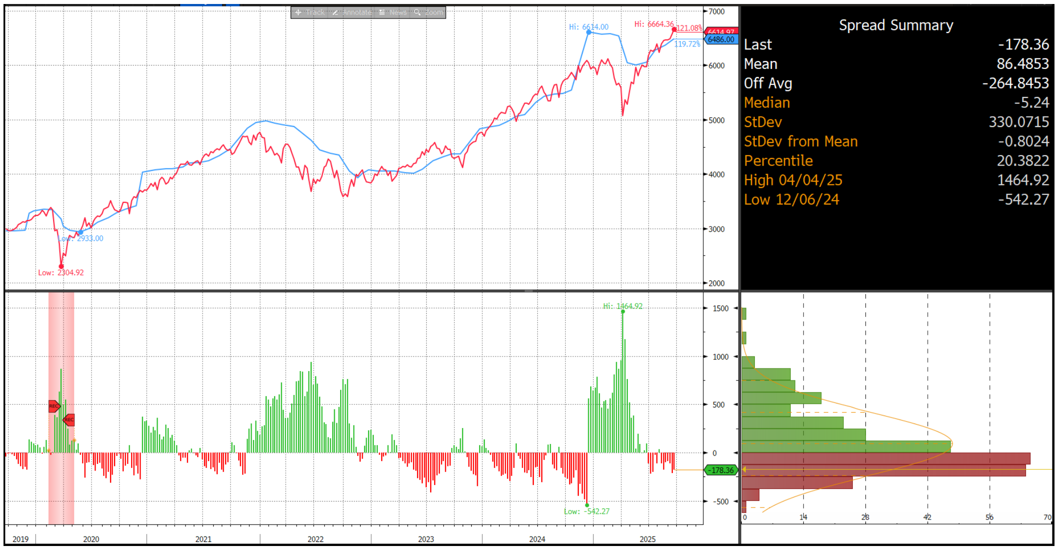
It's often said that markets dislike uncertainty—but not always for the reasons people think. Sometimes markets rise precisely because of uncertainty. In the proper context, uncertainty can conceal opportunity, and this is the wall of worry that stock markets are known to climb. Currently, uncertainty remains notably high, similar to the peaks observed during the COVID-19 pandemic and the subsequent economic shutdown.



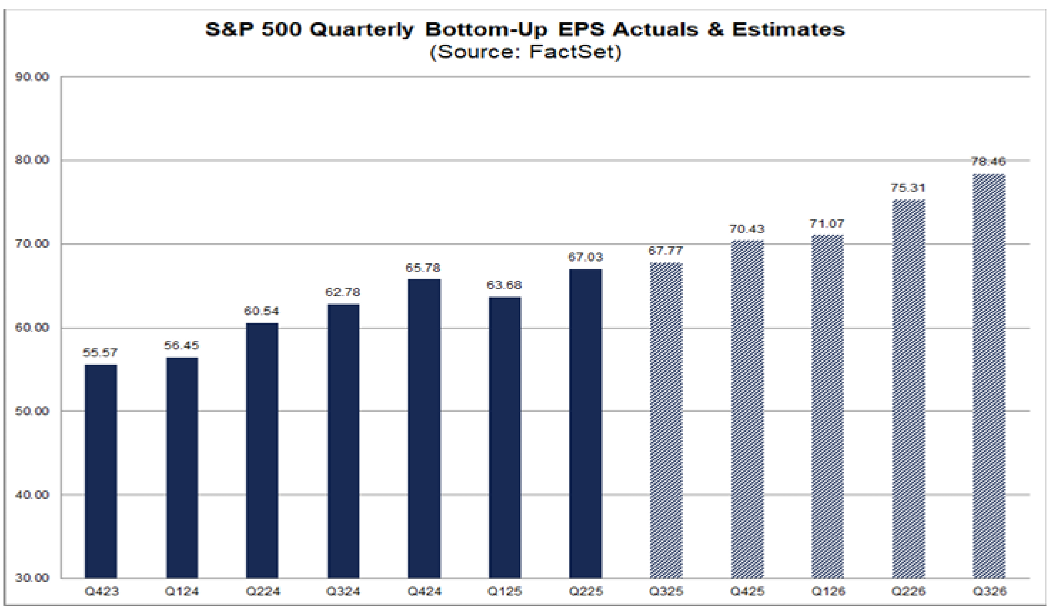
Similarly, the gap between consumer expectations that stocks will rise or fall reached a peak of pessimism in April and has since steadily rebounded. Historically, this signals a more optimistic outlook for the stock market.



Despite headlines, earnings and profit expectations have remained stable and even improved. Strategist targets are below the index price level. This has proven to be an excellent indicator, showing that institutions are still adjusting to current stock prices compared to their expectations and will likely chase the market higher in the coming quarters, playing catch-up. This relationship flips when strategist equity index price targets rise faster than the market, indicating that expectations have now outpaced themselves.

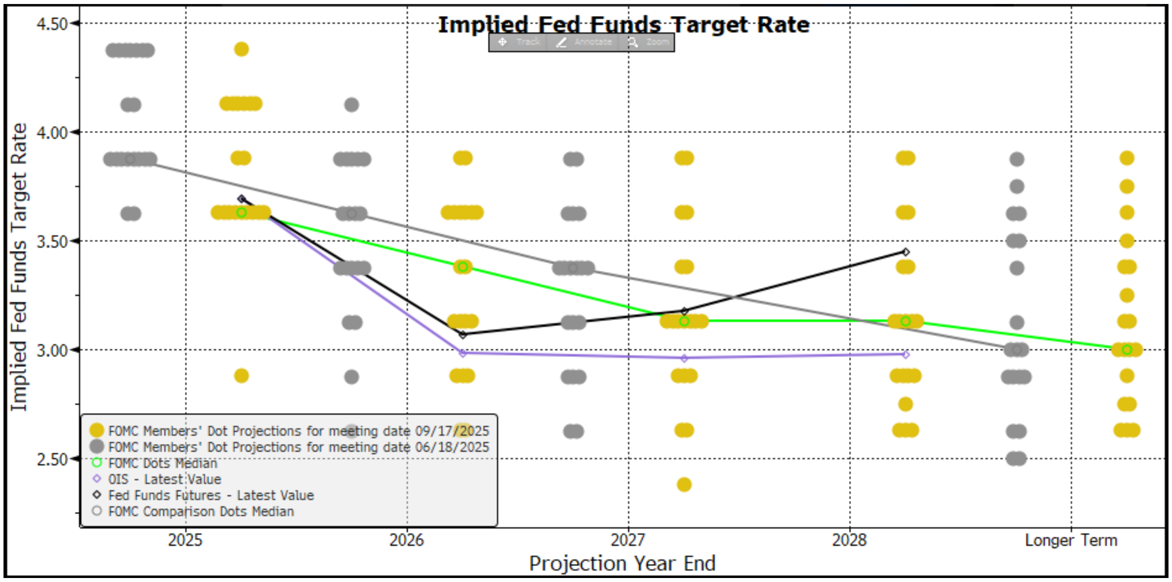


News and events cause short-term swings in sentiment and uncertainty. However, the major market movements are based on expectations for earnings and economic growth over the next 6 to 12 months. Bull markets grow as uncertainty gradually shifts to positive reports of rising incomes and improving economic conditions, encouraging more investors to buy in. What are the chances for earnings growth in the next six to twelve months? Profits are not only increasing but also accelerating upward. Notably, small-cap earnings, which had been steady for two years, are now showing signs of improvement. Analyst quarterly estimates continue to rise.

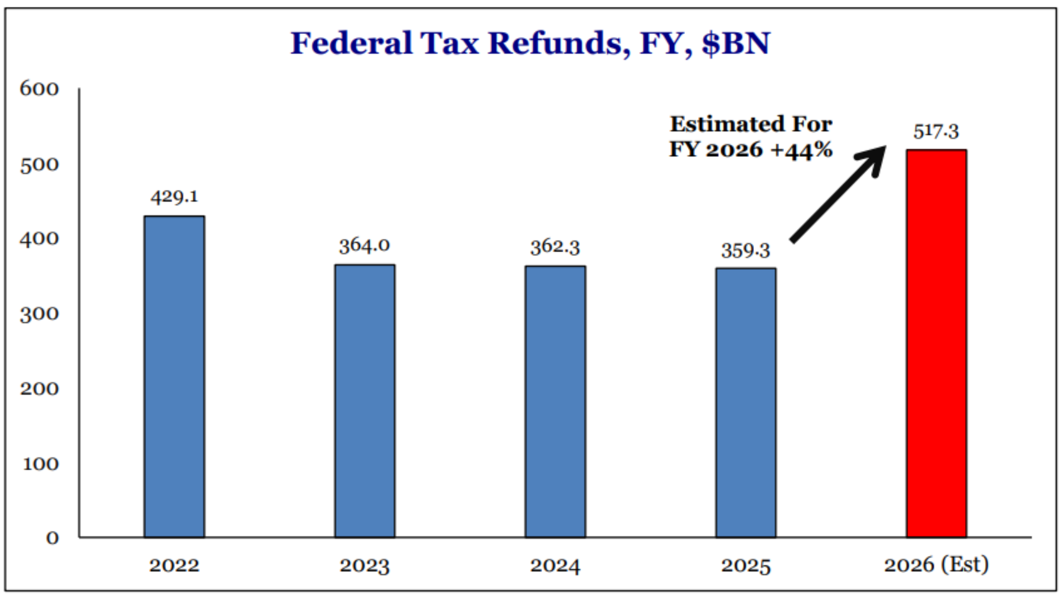


Since the beginning of Q2 2025, analyst earnings revisions have been optimistic, with more upward than downward adjustments, and expectations for quarterly earnings to keep improving—another positive sign.

On the policy side, several positive developments are also emerging. However, median FOMC policy uncertainty remains high regarding growth and inflation, which is why they are mistakenly anchoring on “data dependency,” leading to hedging their forward guidance and insisting on making policy decisions based on backward-looking economic data points. The median dot plot shows two rate cuts by the end of 2025, compared to the FFR of 2 cuts in Q4 2025; one rate cut in 2026, compared to an FFR of 3 cuts in 2026; and one in 2027, with a 50/50 chance of a 2027 cut.



For fiscal policy, a second round of fiscal stimulus for consumers, totaling over $150 billion, is anticipated to arrive in the early 2026 tax season. Consumption accounts for nearly 70% of GDP. Tax cuts, deregulation, and reshoring are all efforts to ignite a capital expenditures (capex) boom for American industry and support median household spending—both of which are positive for corporate revenues and economic activity.

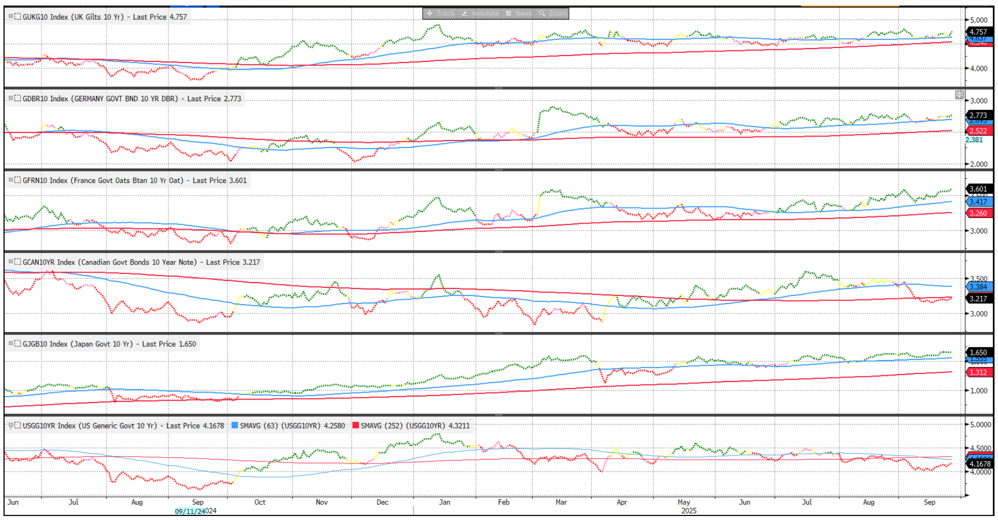


A final note on speculative positioning that can cause marginal flows in markets: since the tariff-induced bottom, traders have become more short, not less. In other words, they are increasingly bearish despite the positive earnings outlook. Likewise, as shown above, policy uncertainty remains at levels similar to those during the COVID-19 economic shutdown. As trade deals are finalized and companies learn how to manage their supply chains, this level of uncertainty gets resolved, with only one direction to go from this unprecedented high level downward. That is definitively bullish. If a growth scare occurs in the US economy in the short term, stocks are unlikely to remain unaffected. Therefore, it is wise to maintain a balanced portfolio of stocks, bonds, and alternatives—used as true diversifiers in the post-2019 world, where markets have demonstrated an increasingly positive correlation between stock and bond returns.

Fixed Income Highlights

Consensus seems to predict a repeat of Q4 2024, when the Fed cut rates and bond yields increased. Currently, the trend in the 10-year UST yield is downward, so the lows for yields in 2025 are likely not fully reflected in current prices. If the US faces a growth scare, support on the short end at the 2-year UST is expected to be around 3.25%, and on the long end, with the 10-year UST, around 3.9%. The most attractive part of the yield curve right now is at the longer end, near 20 years. However, this would only be suitable for more tactical trading positioning, rather than as a longer-term allocation.

The US 10Y UST yield continues to fall as the sovereign bond markets of other G5 nations sell off. Despite the US fiscal situation's woes, international investors can only stomach so much weakness in their own domestic bond markets before they must hold their nose and buy US treasuries. It appears that this time is no different, at least for now.

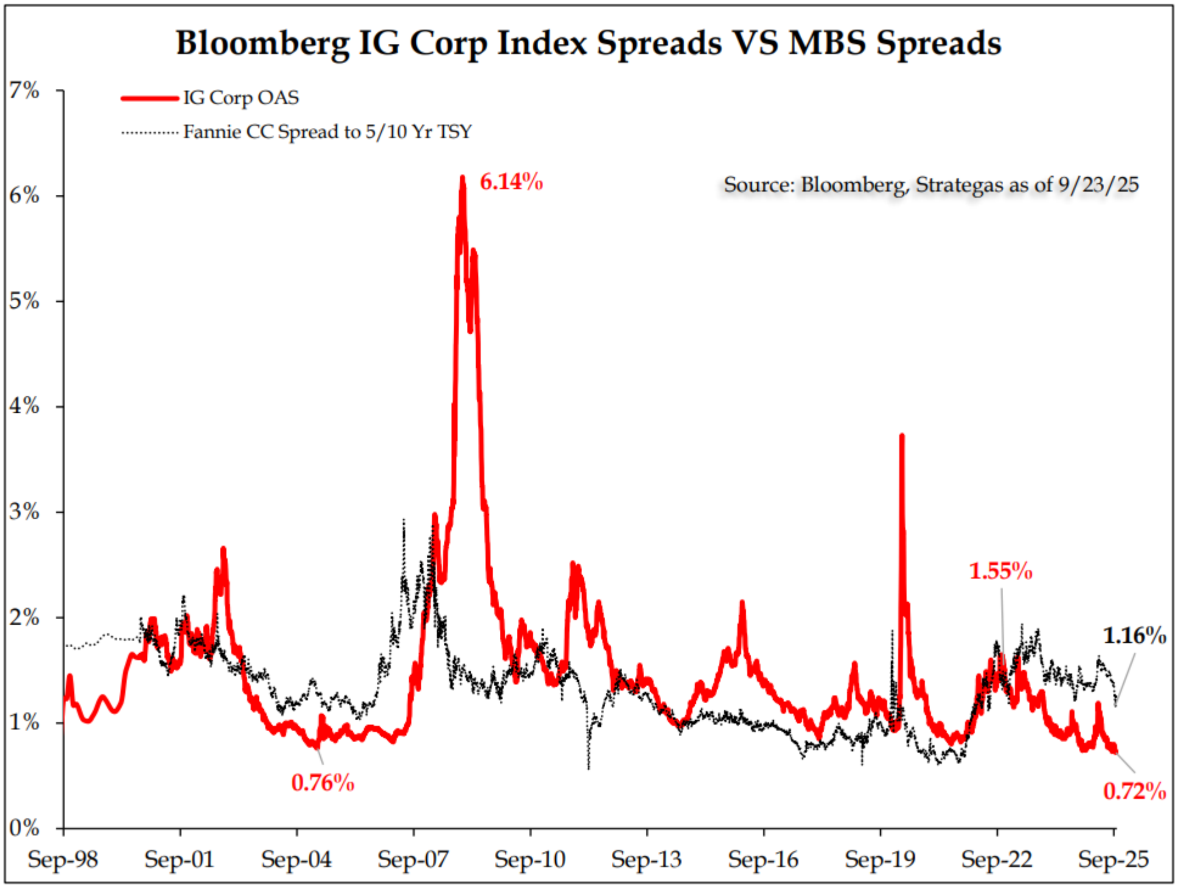


The Treasury yield curve has steepened since spring, mainly due to monetary policy easing, but also because of the spike in bond market volatility following Liberation Day. Six rate cuts are now fully priced in between the end of 2026, and we are beginning to see the curve start to flatten. If the Fed were to adopt a more hawkish stance, a bear flattening would likely occur, with short-term rates rising (and prices falling). Conversely, if the Fed shifts to a more dovish approach, a bull flattener would likely happen, as the long end prices in lower growth and inflation, according to the deflationista argument.

Credit risk is unattractively priced as investment-grade spreads are at three-decade lows of about 70 bps. Although it's important to note that, with healthy earnings and corporate balance sheets holding high cash as a percentage of total assets, there doesn't seem to be a catalyst for spread widening right now. Monetary conditions are easy, and as discussed in the policy section, real policy rates are moving lower, which is clearly a primary reason why corporate spreads remain as low as they are.

Critical points for the fixed-income markets:

- Consensus predicts a repeat of Q4 2024, when the Fed cut rates and bond yields rose.
- The 10Y UST yield continues to fall, and sovereign bond markets of other G5 nations sell off.
- If the US faces a growth scare, support on the short end at the 2Y UST is expected to be around 3.25%, and on the long end, with the 10Y UST, around 3.9%.
- Credit risk is unattractively priced as investment-grade spreads are at three-decade lows of about 70 bps.
- Because of the expected persistent high inflation, deglobalization, and fewer price-sensitive buyers of UST issuance, and increasingly positive correlation for stock and bond returns, we remain cautious about significantly increasing duration as a long-term allocation.



The dollar is still likely to be significantly lower in value 12–18 months from now, due to long-term shifts in Fed policy, supply and demand imbalances in the Treasury bond market caused by capital calls for increased European defense spending, deglobalization, and industrial reshoring, as well as negative carry for Japanese institutions. In the short term, there is clear technical evidence of a rally in longer-term bonds. Because of the expected persistent high inflation, deglobalization, and fewer price-sensitive buyers of UST issuance, we remain cautious about significantly increasing duration as an allocation.

Asset Class Return Rank

Asset Class	2021	2022	2023	2024	2025	10Y Cumulative	10Y Annualized
Gold	(4.2)	(0.8)	12.7	26.7	43.2	139.31	13.09
Emerging Market Stocks	(3.6)	(20.6)	9.0	6.5	27.2	86.73	7.27
Developed International Stocks	11.5	(14.4)	18.5	3.5	24.6	86.08	7.67
US Large Cap Growth Stocks	27.5	(32.7)	55.0	25.6	17.0	219.94	19.10
Bitcoin (Digital Assets)	58.3	(63.9)	153.7	122.5	16.9	2148.40	74.00
US Large Cap Stocks	26.4	(19.2)	26.5	24.3	13.8	152.39	14.12
USD Emerging Market Bonds	(2.2)	(18.7)	10.6	5.5	10.8	41.07	3.62
International Agg Bond Market	(9.3)	(22.1)	5.6	(6.5)	10.2	2.21	(0.32)
US Small Cap Stocks	14.6	(20.5)	16.9	11.4	10.1	103.01	9.31
US Mid Cap Stocks	22.5	(17.5)	17.1	15.2	9.8	117.26	10.80
US Corporate Investment Grade Bonds	(1.8)	(18.0)	9.4	0.9	7.3	35.62	3.11
US Corporate High Yield Bonds	3.8	(11.0)	11.6	8.0	7.1	55.47	5.29
US TIPS	5.7	(12.3)	3.8	1.7	6.7	31.02	2.91
Commodities	41.5	19.4	(6.2)	2.2	6.7	79.34	6.94
US Agg Bond Market	(1.9)	(13.1)	5.7	1.4	5.9	20.49	1.86
Preferred Shares	7.2	(18.2)	9.2	7.2	5.7	39.75	3.55
US REITs	40.7	(26.3)	11.8	4.8	5.3	68.01	5.34
20Y+ US Treasury	(4.6)	(31.3)	2.8	(8.1)	4.8	4.66	(0.50)
Cash ($)	(0.1)	1.4	5.0	5.2	3.1	19.54	1.94
Agriculture	22.4	2.5	7.7	33.5	1.5	46.38	3.93

Highest Return	58.3	19.4	153.7	122.5	43.2	2148.40	74.00
Lowest Return	(9.3)	(63.9)	(6.2)	(8.1)	1.5	2.21	(0.50)
% Asset Classes Positive	60%	15%	95%	90%	100%	100%	88%