



Capital Markets Commentary – October 2025

As widely expected, the Fed dropped the overnight lending rate last month by 25 bps. The decision was nearly unanimous, stirring up significantly less drama than many had expected. Some pundits expected the Trump appointees to agitate, as a group, for a deeper cut, but in the end, the lone dissenter was newly appointed member Stephen Miran who lobbied for 50 bps.ⁱ This is not to say that individual members aren't wearing their Team Dove, or Team Hawk jerseys beneath their Brooks Brothers. In remarks to the media following the meeting, those jerseys were worn on the outside. Governor Bowman touted Team Dove in remarks made to the Kentucky Bankers Association, while Goolsbee on CNBC and Musalem on Bloomberg sided with Team Hawk.

Given the simultaneous threats to both arms of their dual mandate, the Fed is hardly in an enviable position. In remarks made to the Providence RI Chamber of Commerce on September 23rd, Fed Chair Powell lamented that, "There is no risk-free path," adding:

"If we ease too aggressively, we could leave the inflation job unfinished and need to reverse course later to fully restore 2%. If we maintain restrictive policies for too long, the labor market could soften unnecessarily. When our goals are in tension like this, our framework calls for us to balance both sides of our dual mandate."

Godspeed, Chair Powell, we are counting on y'all to get this right. Fed aside, perhaps the bigger news at the moment is the government shutdown that began Tuesday night the 30th. We'll discuss the shutdown and its potential impacts, but first, let's look at the numbers for September.

September was, again, another month in which every major global equity index closed in the green. In the US, it was the NASDAQ that came out ahead, closing the month with a gain of 5.7% followed by the S&P 500 which gained 3.6% and the Dow which was up 2%. Europe likewise turned in positive returns with the Eurozone STOXX 50 gaining 3.9%, while in Asia, Hong Kong's Hang Seng added a whopping 7.8% and the Japanese Nikkei 225 closed 5.2% to the good. Bond yields, as measured by the ten-year US Treasury lost ground, as you might imagine but not by as much as the overnight rate cut. The ten-year closed August at a yield of 4.22%, dipped to as low as 3.99%, and then climbed again to close September just 8 bps lower for the month.ⁱⁱ So, with the housekeeping out of the way, let's move on to the shutdown.

The last time the US government closed for business was December 22, 2018. As Congress had passed a handful of spending bills prior to the deadline, the 2018 shutdown was only partial, but it was long, clocking in at thirty-four days – a government shutdown record. Thus far in 2025, though, Congress has passed diddly in the form of spending bills, so this shutdown will be complete. Our Congressional representatives will continue to be paid regardless (which strikes us as more than a little unfair), but other federal workers will go without and for many other Americans, there will be inconveniences.

One of our young colleagues is planning to leave town next week for a long-scheduled vacation to Hawaii. For starters, he's liable to run into delays at airport security. Although TSA agents are still required to report to work, they won't be paid so it seems safe to assume that attendance will be less than 100%. The same goes for air traffic controllers. The hi-light of his itinerary was to be a visit to the USS Arizona Memorial at Pearl Harbor, a national park that will probably be closed if the shutdown lasts that long. Our men and women in uniform will be expected to continue working, unpaid, but most workers in less sensitive fields will be told to stay home. The Bureau of Labor Statistics will not be reporting non-farm payroll data on Friday the 3rd and a swath of other data will be at the very least delayed, but other than some interval through which Wall Street will fly blind, will markets really care?

If history repeats itself, markets probably won't care much. Below, we've linked to a report on the topic from Morgan Stanley's Monica Guerra, Head of US Policy, should you be interested in reading the whole thing, but we include a selection of her key points here:

- Since 1976 there have been twenty federal government shutdowns lasting on average eight days.
- On average, real quarterly GDP growth has *increased* 2.2%. Monica notes, however, that impacts to GDP may be greater this time since the shutdown is likely to be full rather than partial. Furthermore, this time the Trump administration has indicated that it might use a shutdown as a pretense to permanently cut federal jobs.
- The S&P 500 Index has risen 4.4% on average during shutdowns.

Remember, though, these numbers are based upon the average shutdown lasting just eight days. A full shutdown lasting much longer than eight days could well challenge these assumptions. The longer it goes on, the harder it will be on people, particularly inside the government, but neither will it be a picnic for the average tax-paying citizen (just ask our young friend whose vacation may or may not now happen). With any luck, though, the shutdown, in terms of markets at least, will amount to not much more than noise. That noise, however, comes at a time when valuations are challenging. Powell, in that same Rhode Island forum was asked how the Fed viewed equity markets in relation to rate decisions. He replied:

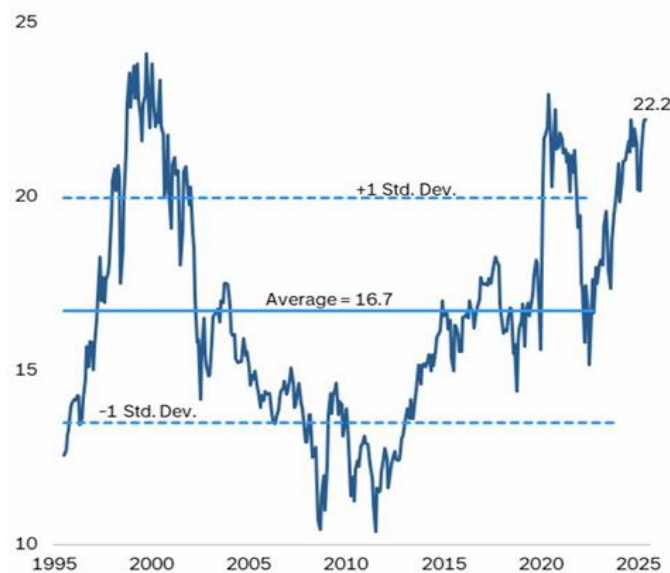
“We do look at overall financial conditions, and we ask ourselves whether our policies are affecting financial conditions in a way that is what we’re trying to achieve, but you’re right – by many measures, for example, equity prices are fairly highly valued.”

Note that he didn’t say they were overvalued, but it would be hard to argue that equity prices are not, as he said, *fairly highly valued*. The chart below shows us the forward PE for the S&P 500 and the price-to-sales ratio going back to 1995. One doesn’t need an econ degree to get the point.

US Stocks Valuation Metrics

S&P 500 FORWARD P/E RATIO

AS OF AUGUST 31, 2025



PRICE-TO-SALES OF S&P 500

AS OF AUGUST 31, 2025



Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet. Standard deviation (volatility) is a measure of the dispersion of a set of data from its mean. Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

But it's important to note that not every company in the S&P is overvalued. The quantitatively overvalued stuff is heavily concentrated in AI. According to Morgan Stanley's Global Investment Committee (GIC) AI data center ecosystem stocks have "accounted for roughly 75% of S&P 500 returns, 80% of earnings growth, and 90% of capex growth." We can't help but think back to the dot-com bubble. In retrospect, the internet was even more revolutionary than the most wildly optimistic prognosticators thought it would be in 1999, but it took years for companies to turn that revolution into revenue. Not known for patience, investors drove valuations for dot-com stocks into the stratosphere. It did not end well. There's an old quote from Bill Gates, "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten."

Here's our point. At Graystone Charleston, the question of whether Artificial Intelligence (AI) can accrue to the betterment of humanity or not is a topic of hot debate. If we put the issue to a vote tomorrow morning in our daily team meeting, the AI-is-good argument would win hands down (the counter side of the argument might garner a single lonely vote).

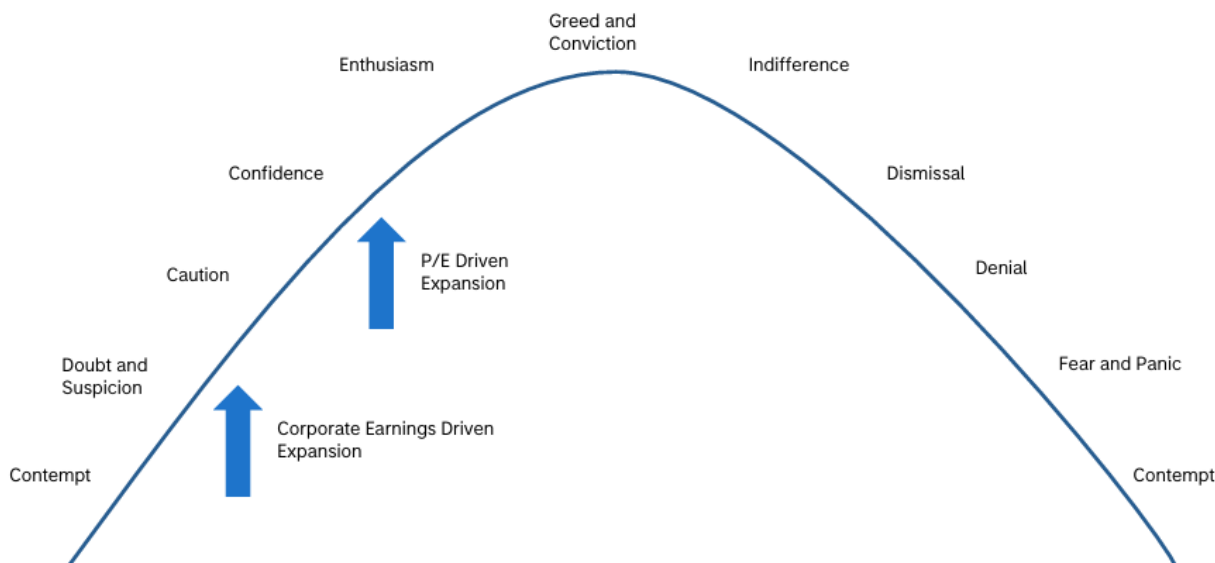
The more important question today, though, is whether or not all of this AI-driven capex spending and its outsized impact on GDP is sustainable **near-term**, and whether or not the valuations of sector components are reasonable **near-term**. It's tempting, we know, to want to chase these stocks as they run but valuations do matter and there's a vast opportunity set of companies that offer a potential opportunity for growth at a reasonable price. We believe, particularly given the litany of uncertainties at play today, that if there was ever a time to abandon the doctrine of the diversified portfolio, now is not that time.

We leave you with a slide we haven't shared in quite a while that illustrates the range of emotions investors often experience as we cycle from bear to bull and back to bear (because even though it's been ages since we've seen one, bears do happen). Your tolerance for risk should not change from one side of this chart to the other. It is what it is. We're ready and eager to talk about whether or not your holdings and risk tolerance are in-sync any time you are. Just give us a call – we always look forward to hearing from you.

The Investor Psychology Cycle – Herd Mentality

For Illustrative Purposes Only

“Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria” – Sir John Templeton



Source: Morgan Stanley Wealth Management GIO, Bloomberg. **FOR EDUCATIONAL USE ONLY**

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Link to Monica Guerra's report here: [Do Government Shutdowns Matter to Markets?](#)

ⁱ Source: <https://www.federalreserve.gov/newsevents/pressreleases/monetary20250917a.htm>

ⁱⁱ Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet

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Dow Jones Industrial Average (DJIA). A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

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