Last quarter, I was introduced to a fascinating new hobby: birding! Picking up this pastime in the fall meant that I was able to observe dozens of migrating species as they passed through Chicago. In doing so, I wondered how so many birds survive the winter without making a long trek South. I learned that birds who opt to sit out the cold have developed fascinating tools to help them from freezing. Some of these tools include cleverly designed blood vessels and a form of temporary hibernation called torpor. Although the tools we use to prepare for challenging times in the financial world are not genetically encoded like those of our avian counterparts, they are no less valuable. Developing sound budgeting habits, crafting an appropriate asset allocation, and being disciplined in investment selection are tools that have historically enabled investors to weather markets, no matter how frosty they may become.

Far from being frosty, however, markets were white-hot in Q3 of 2025. The S&P 500 saw an increase of 8.1%, bringing year-to-date returns to 14.8%. Growth stocks, represented by the Russell 1000 Growth index, returned 10.5%, while the Russell 1000 Value index rose 5.3%. As of September 30th, 2025, the Russell 1000 Growth was up 17.2% and the Russell 1000 Value was up 11.6%. Internationally, the MSCI EAFE rose 4.9%, bringing year-to-date returns to 25.8%. The MSCI Emerging Markets index also fared well, returning 10.9% in the last quarter and 28.2% year-to-date.[1]

Several themes drove markets to greater heights last quarter, but a major one was artificial intelligence (AI). By mid-July, private investments in Artificial Intelligence and Machine Learning in the US totaled $275 billion, and the figure continues to rise.[2] In the public sphere, a large fraction of US equity market returns were derived from continued outperformance of AI-related names. As corporations invest billions of dollars into these technologies, many investors have been asking whether this level of market ebullience is beginning to resemble a bubble. Lisa Shalett, Chief Investment Officer and Head of the Global Investment Office at Morgan Stanley Wealth Management, addresses this question in a recent publication:

The data center capex boom that began in earnest following the 2022 bear market has seen annual "hyperscaler" capex surge from about $100 billion to over $400 billion… This is outsized compared to virtually anything seen in the internet bubble…This comes as Census Bureau survey data indicates that AI usage and adoption are plateauing across every enterprise size, having apparently peaked at around 14% of the largest companies in June before falling to about 11% in August. This confirms MIT Media Lab and Project NANDA research from August suggesting that 95% of AI pilots used at companies have so far produced no measurable return or productivity improvement. Our point is not to express doubt about the technology's long-term potential but about the timing, as well as the likelihood that as adoption proceeds, data center growth will slow, with capacity outpacing immediate return on investment.[3]

Although the opportunities offered by AI adoption are exciting from a productivity and growth perspective, current valuations in the S&P 500 at a 22.8x forward price/earnings (P/E) ratio[4,5] reflect little hubris on the part of markets (the 30-year average P/E was 17.0x as of 09/30/2025[4].) Our response to such optimism is to approach asset allocation decisions with intention, and to ensure that concentrations remain in-check in the face of above average valuations.

Bond investments also enjoyed a positive third quarter on the back of healthy (albeit slowing) economic data and the announcement of a 0.25% Federal Reserve rate cut in September.[6,7] Morgan Stanley's economists currently "expect a 25 basis-point cut at each of the next three Fed meetings— October, December and January—followed by a pause and two more cuts, in April and July next year."[5] With these statistics in mind, many investors have been asking why mortgage rates remain elevated. Much of this dynamic has to do with how these cuts have impacted the yield curve. Mortgage rates are generally set based on the 10-year treasury yield. Although shorter term rates have come down following the most recent FOMC meeting, the yield curve has steepened, meaning that longer term rates (such as the 10-

year yield) have not come down as much as short term rates.[8] The natural question becomes, why have longer term rates not experienced the same reduction? The answer to that question comes down to uncertainty and expectations. The longer the time between now and the maturity of any given bond, the higher the risk of a change in circumstances. Generally, the changes in circumstances that investors factor into long-term yields are fluctuations in inflation, economic growth, and central bank policy expectations. If longer-term expectations for growth and inflation remain elevated, long-term rates do too.

On October 1st, 2025, the government shut down as democrats and republicans disagreed on how to resolve a budget dispute, leaving hundreds of thousands of government workers furloughed and several non-essential government services paused. Although no one knows how long the shutdown will last, I do think a brief review of the historical impacts of previous shutdowns and how they have impacted the economy and markets is in order. In a recent research report, our US Economics team broke down historical data into economic and market impacts. “An analysis of quarterly GDP growth during prior government shutdowns since 1976” indicated that the impact of a shutdown on GDP has historically been mildly negative. “Using the last shutdown, which occurred in 2018-2019, as a guide, the US economy was estimated to have permanently lost only $3 billion in GDP in the following quarter… indicating that the level of total annual GDP that year was just 0.02 percentage points smaller than it would have otherwise been.”[9] Additionally, “equity performance during shutdowns and amid periods of government uncertainty has largely been affected by other macroeconomic factors. For example, S&P 500 Index returns were not strongly correlated with the length of a shutdown. In fact, the S&P 500 Index has risen 4.4%, on average, during government shutdowns, and is positive over the last five shutdowns—indicating that macroeconomic, thematic, and cyclical factors play a greater role in market performance than legislative deadlocks.” [9]

With so many changes happening in our geopolitical and economic landscape, it is easy to feel overwhelmed. Much like birds who use the earth’s magnetic fields, the sun, and the stars to get them to where they need to go in the fall, our team continues to rely on time-tested approaches to portfolio construction and financial planning to lead our clients through turbulent times.

Thank you for your continued trust in our team!

Best,
Fatimah Hijjawi, CFA ®
Financial Advisor
Financial Planning Specialist
NMLS #2567004

The Eleven Twenty Seven Group at Morgan Stanley
233 South Wacker Dr Ste 8600
Chicago, IL 60606
Direct: 312 648 3330
Mobile: 773 965 0443
Fax: 312 445 9309
Fatimah.Hijjawi@morganstanley.com
https://advisor.morganstanley.com/the-eleven-twenty-seven-group

Connect with me on LinkedIn

Learn about our team by viewing our video here

Pacesetter's Club Member since 2025

Named one of Forbes Best-In-State Wealth Management Teams for 2023, 2024, and 2025
2023, 2024, and 2025 Forbes Best-In-State Wealth Management Teams
Source: Forbes.com (Awarded 2023, 2024 and 2025). Data compiled by SHOOK Research LLC based on 12-month time period concluding in March of year prior to the issuance of the award.
Awards Disclosures

1. myGIO: Powered by the Global Investment Office
2. Thematics: Venture Vision: Artificial Intelligence Landscape
3. The GIC Weekly: A Shrinking Margin for Error
4. JP Morgan Guide to the Markets Forward PE
5. Waiting for the Fall
6. Fixed Income Insights: The Fed Cuts Its Policy Target by 25 bp, Citing Downside Labor Market Risks
7. Fixed Income Insights: Fixed Income Calm Prevails Amid Macro and Policy Transitions
8. The Fed, Mortgage Rates.pdf
9. US Policy Pulse: Do Government Shutdowns Matter to Markets?

Morgan Stanley Wealth Management Pacesetter's Club members must meet a number of criteria including performance, conduct and compliance standards, revenue, length of experience and assets under supervision. Club membership is no guarantee of future performance.