

# The Legacy Group, Inc.

Dear Legacy Clients,

Thank you for your continued partnership and trust, and welcome to our quarterly economic and investment update. In this letter, we will be detailing our thoughts on the current investment landscape, reflecting on the third quarter of 2025, and providing our general economic/investment outlook going forward.

Equity markets continued to reach new highs this quarter, building on positive momentum established in April after President Donald Trump announced a 90-day pause on the very high tariff rates first announced on April 2<sup>nd</sup>. Last quarter, we talked about the August 1<sup>st</sup> deadline for this pause, at which point these broad and sweeping high tariff rates were set to return, but it never fully materialized. One of the main reasons why is because many different imports are exempt from these tariffs provided certain conditions are met. A primary example of this is seen with Apple, which has essentially navigated tariff threats by promising President Trump an additional \$100 billion in U.S. investment. Additionally, the August 1<sup>st</sup> deadline was pushed back even further in some instances. On October 10<sup>th</sup> however, Donald Trump once again threatened 100% tariffs on all Chinese imports starting November 1<sup>st</sup> after China imposed new controls on their exports of rare earth minerals. Right now, we are still in the early phases of this announcement, but we should remind ourselves of how rapidly this administration alters its trade policy. For most of the third quarter, markets were not thinking about trade war threats, but rather, an economic softening in the context of a slowing U.S. labor market. Last quarter, we mentioned that our labor market was still strong as it was adding plenty of new jobs each month, but the U.S. employment report released on August 1<sup>st</sup> showed massive downwards revisions of the number of jobs added for the months of May and June. Investors soon realized that there are inherent flaws with the surveys that comprise these monthly data releases, and American businesses are not hiring as many new workers each month as had previously been thought. Possible reasons for this could be a reduction in labor demand due to uncertainties about the future of tariffs and the effect they will have on these businesses, as well as a reduction in labor supply due to stricter immigration policy.

The biggest significance of this development in our opinion is its potential impact on the future of the Federal Reserve's interest rate policy. The Federal Reserve (the "Fed") is tasked with a dual mandate from Congress: stable prices and maximum employment. They raise interest rates higher when they want to slow down the economy thereby reducing inflation (aka stabilize prices), and they cut rates lower when they want to support the economy and labor market. The idea is that lower rates reduce companies' cost of capital which should allow them to spend more on growth. This matters for the stock market as well since lower rates are generally supportive of stock prices. At the Fed's September rate meeting press conference, Fed Chair Jerome Powell stated that downside risks to employment have risen, indicating that the Fed is shifting its focus from inflation to the labor market. The market began pricing in more rate cuts as a result, although Powell did reiterate that he still wants to be patient with the speed at which they cut rates to ensure that any potential tariff-related inflation remains muted. Despite this, President Trump wants the Fed to cut faster in the hopes that it will help reduce the expenses that the government pays on its debt issuance. As a result, the administration has publicly stated their intent to appoint a new Fed chair when Powell's expires in May of next year. The concern here is that the new Fed chair might be someone who is more acquiescent to the President's demands.

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While we as investors generally do favor lower rates, the stock market would not react kindly to a scenario that involves the Federal Reserve losing its independence. Thankfully, the stock market does not seem to be pricing in this scenario as a high-likelihood risk, and we tend to agree. At the September press conference, Powell reminded us that no one person can solely decide the path of interest rates set by the Federal Reserve, as the decision is made collectively by the Fed chair and 11 other voting members on the Federal Open Market Committee.

With respect to current inflation, the annual PCE inflation rate (“PCE” inflation is the Fed’s preferred measurement of inflation) is 2.7% as of August. This is higher than the 2.3% number we reported last quarter, and further from the Fed’s 2% target, but still lower than the 2.8% number we reported in the first quarter. Progress toward an annual rate of 2% inflation has clearly stalled, as we are currently seeing some pickups in services inflation, as well as some early signs of potentially tariff-induced goods inflation. We mentioned in our last two letters that tariff-related goods inflation could be coming soon, and we believe we are entering into that timeframe now, and expect inflation to stay in the high 2’s or even tick a little higher in the short term. Regardless, we still believe that inflation should continue to cool over time, as a large portion of current inflation is being driven by higher shelter prices. We believe that continued price pressure in this area is likely not sustainable. On top of this, we see continued progress (albeit slow and steady), in the trend of declining wage inflation as measured by the Federal Reserve Bank of Atlanta’s wage growth tracker.

Although it is easy to fixate on the current administration’s significant policy changes that may be contributing to the hiring slowdown, Franklin Templeton’s quarterly “Anatomy of a Recession” research indicates that hiring slowdowns are typically witnessed as economic cycles mature. This research also currently predicts that the U.S. economy is firmly still in expansion today, indicated by many other indicators besides job sentiment. The current labor market has often been described as “low hiring low firing” to emphasize the point that just because new jobs aren’t being added as quickly doesn’t mean that joblessness is on the rise, as it would be in a recessionary environment. This is supported by the fact that we are still seeing relatively low levels of weekly initial claims for unemployment insurance. August’s read of the U.S. unemployment rate itself is 4.3%, and has been hovering in the 4-to-4.3% range since July of last year. These are low numbers historically speaking, and we don’t foresee any rapid increase on the horizon mainly because we still have 7.22 million job openings as of August, which should help buffer against any rapid increase in joblessness.

Looking beyond our labor market, other datapoints related to economic growth signal continued strength and resiliency. The Federal Reserve Bank of Atlanta forecasts above-trend economic growth of 3.8% (annualized) for the third quarter. Consumer spending makes up 68% of U.S. GDP, and the aggregate consumer still appears to be in very good shape. JPMorgan’s quarterly “Global Asset Allocation Views” publication states that their proprietary Chase data shows signs of consumers committing to larger discretionary purchases. There are some signs that the low-end income consumer is pulling back on spending, but high-net worth individuals make up a disproportionately large amount of total consumption in the U.S. Regardless, significant tax cuts proposed in the “One Big Beautiful Bill” should fuel consumption across all income levels even further in 2026. The longer-term deficit increases from this bill will have to be addressed at some point in the future via higher taxes and/or reduced spending, but in our view, this is a much longer-term issue that is fundamentally impossible to predict.

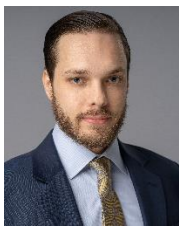
This quarter’s stock market rally has been called an “everything” rally, as new hope for rate cuts

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buoyed a broad range of sectors, while positive sentiment surrounding the AI buildout benefited large cap tech. As the largest U.S. public tech companies continue to invest in the future of AI, concern has risen that this investment will not be sustainable if they do not soon generate returns on capital. Others such as Datatrek Research's Nick Colas assert that most of these companies are investing well within the limits of their operating cashflows when considering reasonable projections for future cashflow growth. We believe this is what separates this high-multiple tech stock market from the one we saw in 1999. Broad S&P earnings growth remains in the high single digits, coupled with projections for earnings growth to broaden out from the "magnificent 7" stocks (Nvidia, Microsoft, Apple, etc.) to the rest of the S&P 500. International equities also rallied significantly this quarter, building on momentum set in place at the start of the year with the drop in the value of the U.S. dollar relative to foreign currencies. We believe the dollar has room to fall further from here due to the combination of lower U.S. rates and improving global growth. Bond performance was muted this quarter as 10-year treasury interest rates oscillated between 4% and 4.5%, and gold rallied to newer highs over the course of September.

As the market shifts its attention between tariff fears and a slowing jobs market, we should remind ourselves of how quickly different macro narratives pass in and out of headlines. Ironically enough, weakening jobs data has somewhat created a "bad-news-is-good-news" stock market environment, wherein stocks sometimes react positively to poor jobs data since it potentially increases the likelihood that the Fed cuts rates. On some level this makes sense, since the risk of higher firings still seems low. Ultimately, the fact remains that our economy stands on strong fundamental footing, insulated by the strength of our consumer, and the Federal Reserve still has the ability to cut interest rates more and support it if necessary. We hope that you find these updates helpful, and please do not hesitate to reach out if you have any questions.

Sincerely,



Austin Smith, Analyst for The Legacy Group, Inc.

Craig Lestner, CFP® President

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## Resources used:

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## DataTrek Research: DataTrek Morning Briefing

- September 17, 2025: “Powell Presser, New Dots/Funds Odds, Big Tech Earnings Revisions”
- September 25, 2025: “STT: IPOs Matter a Lot”
- October 2, 2025: “STT: The ROI Of Gen AI”