

Market Recap

Steady Gains in Q3 Set the Stage for a Cautious Q4

After a volatile start to the year, we believe equity markets found steadier footing in the third quarter of 2025. The S&P 500 rose about 7.8%, the Dow advanced around 5.2%, and the Nasdaq outpaced both with an ~11% gain. What distinguished the quarter wasn't only the strength of those gains but the relative absence of volatility. Compared with the sharp swings of the first half, Q3 delivered a smoother climb, led, once again, by technology, communication services, and consumer discretionary stocks.

Three dominant themes are believed to have sustained the rally: optimism around artificial intelligence and corporate capital spending, stronger-than-expected earnings, and a Federal Reserve that eased rates and shifted its sentiment. Together, these forces buoyed investor confidence as we head into the fourth quarter of 2025.

The AI Momentum

Artificial intelligence (AI) remains the defining storyline of 2025. In Q3, major technology firms underscored their commitment to this sector with continued capital spending on data centers, semiconductors, and software platforms. Microsoft, for instance, announced a multibillion-dollar “neocloud” pact to expand compute capacity for large-scale model training.

BlackRock’s global outlook also highlights how AI’s influence now extends beyond the obvious tech names into adjacent sectors such as industrials, energy, and infrastructure, areas that supply the necessary hardware, power, and connectivity to support continued digital expansion.

The optimism behind these AI investments was reflected in Nasdaq’s double-digit quarterly performance, as well as in late-September equity inflows, which was driven by enthusiasm for AI and rate cut expectations, even as investors debated the sustainability of valuations.

Taken together, these developments suggest a more disciplined narrative than in prior cycles: AI is being integrated into core business operations and is, increasingly, being treated as an essential capital infrastructure rather than a speculative theme.



Earnings Resilience

In many prior cycles, earnings weakness exposed vulnerabilities in the market but not in Q3. Companies across sectors delivered results that generally beat expectations, and guidance remained broadly upbeat.

Sectors such as consumer discretionary and communication services, which are typically sensitive to macro swings, held up better than expected. Advertising, streaming, and branded goods remain relatively resilient, reinforcing the case that demand hasn’t dissipated under inflation pressure.

Of course, elevated valuations mean that even marginal disappointments in future earnings or guidance could provoke reactions. But for now, this resilience has reassured investors that valuations, though high, may still rest on a sound foundation.

A Softer Fed

Perhaps the most consequential development in Q3 was the Federal Reserve's shift in tone. After more than a year of their patient stance, policymakers cut rates by 25 basis points in September and signaled the possibility of two additional cuts before year-end. The pivot from focusing narrowly on inflation to also monitoring labor market conditions much more closely, had immediate market impact.

For what has been a tough stretch the last few years, the optimism around fixed income investing continues to gain more traction, as evident in recent price appreciation. With the market currently anticipating further rate cuts, it is likely many investors and asset allocators are moving further down the yield curve and potentially out of the large balances in money market funds.

What to Watch in Q4

Even as the third quarter's performance felt calm and steadily higher, market breadth remains narrow; and handful of large-cap, tech-oriented names still drive a disproportionate share of returns.

Another emerging concern is the divergence between economic growth and employment. U.S. GDP continues to expand at a robust pace, but job creation has softened. That anomaly raises a red flag for consumer resilience heading into the holiday season. If the jobs picture sours further, the link between incomes and spending becomes more fragile than most investors expect, which is a pivotal test for both corporate earnings and investor sentiment.



The third quarter proved that markets can rise steadily when innovation is met with capital investment. Yet the very factors that powered Q3 - AI investment, earnings strength, and a softer Fed - are now the ones that investors will need to scrutinize most closely in the months ahead. AI remains a powerful tailwind but stretched valuations and concentration risk demand selectivity. Corporate performance has been resilient, but holiday spending will test the strength of consumers facing a softer labor market. And while the Fed's shift toward easing has buoyed sentiment, the path of rates is far from settled.

As we move further into Q4, the lines between opportunity and caution will likely define the investment landscape. The calm waters of Q3 provided a welcome reprieve, but whether that stability extends through year-end will depend on how these crosscurrents unfold. For investors, the opportunity lies not in chasing the rally of the past quarter, but in identifying the appropriate goals, objectives, and risk adjusted asset allocation for their portfolio.

Disclosures:

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation. It is a market value weighted index with each stock's weight in the index proportionate to its market value.

The Nasdaq 100 Index is an unmanaged group of the 100 biggest companies listed on the NASDAQ composite index. The list is updated quarterly and companies on this index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology and retail/wholesale trade.

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