2025

THIRD QUARTER

GKV CAPITAL

MARKET
REVIEW
AND OUTLOOK

The Stock Market is Not the Economy

3Q25 DATA POINTS

S&P 500	+13.7%
GLOBAL EX. US	+26.0%
REAL ESTATE	+6.2%
US BOND INDEX	+6.1%
10-YEAR TREASURY YIELD	4.16%
S&P 500 LTM DIVIDEND YIELD	1.25%
S&P 500 12-MONTH EPS	$292.27
S&P Foward P/E	22.9x

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Opening Thoughts

Back in August we had the chance to get together with many long-time clients, former employees, colleagues and friends to mark the 50th anniversary of our firm. The occasion reminded us of all the people involved in the process of managing assets and just how important this endeavor is to our clients that put their trust in us and how critical all the members of our team, both past and present, are in accomplishing this endeavor.

Ahead of the festivities, the current employees of the firm gathered for some team building where we discovered some hidden talents. Our first destination was axe throwing. Sarah intelligently planned that first activity prior to cocktails. It was quite a sight to see Tina wielding an axe! Be sure to stay on her good side. After throwing axes at imaginary zombie hordes, we headed to an escape room. Bill threw himself into every puzzle and was visibly crestfallen on the couple of occasions we were forced to concede and asked for a clue. Proudly, we were told we asked for one less clue than the average team. We will ignore the possibility that they tell that to every team.

On our website and in our marketing, we highlight that at GKV clients receive real advice, for real life, by real people. We truly appreciate the trust that our clients have placed in us. If there is anything we can do better, please let us know.

Every quarter we aim to share some (hopefully) valuable insights or perspective through this quarterly update. Some quarters are more insightful or entertaining than others. This quarter we are less entertaining but hopefully informative. The last several years have been good for investment performance. After nine months, this year is turning out better than we expected. At the risk of sounding ungrateful, strong performance makes one question where we go from here.

In this industry there are many pundits and even more opinions. It is our job to decipher the signal from the noise with the goal of distilling everything down to what really matters. With more noise than ever, it is easy to get distracted and confused. Our North Star is earnings. This year, earnings have come in a bit lower than the very aggressive forecasts but good enough to move stocks higher.

3Q25 Review

The third quarter of 2025 continued the market rebound from the post-Liberation Day lows in April and closed at highs for the year. Investors were in "risk-on" mode and powered the S&P 500 and Nasdaq indices to new record levels. Enthusiasm for AI investments drove technology companies higher and leading names continued their strong performance. Nvidia recently crossed $4.5 trillion of market capitalization, exceeding the GDP of all but the largest economies in the world.

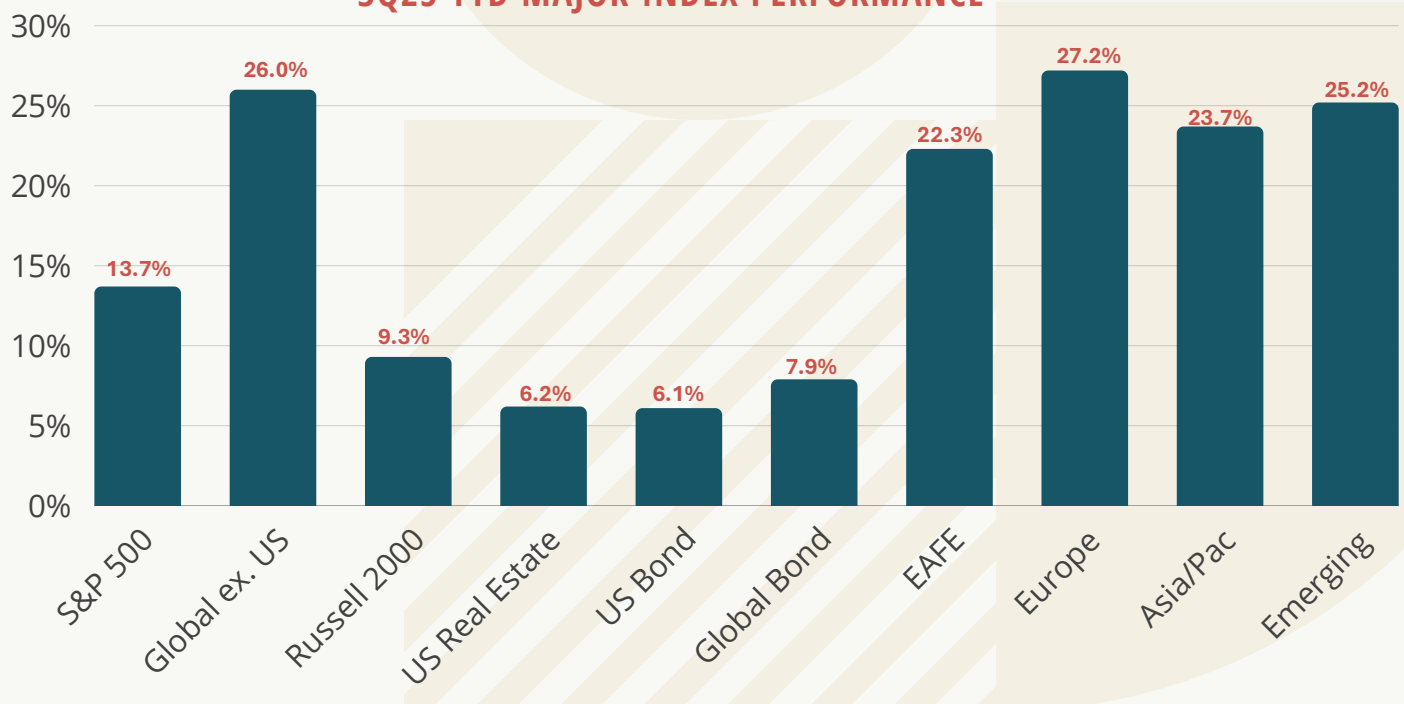
After the initial April 2nd tariff announcements shocked investors and sparked a massive sell-off in the markets, the Administration adopted mitigating measures that reassured investors there would be pathways to acceptable solutions. Meanwhile, the U.S. has now taken investment and/or market positions with U.S. companies in key industries such as semiconductors and pharmaceuticals, as the federal government leans into the Art of the Deal. Myriad risks around policy uncertainty, tariff impacts, Federal Reserve independence, and even government shutdowns haven't deterred the market from setting new records seemingly every week.

The S&P 500 ended the third quarter up 13.7% for the year and the Nasdaq is up 18.0%, while bonds are up 6.1%. Optimism around interest cuts has breathed new life into the Russell 2000 index that tracks small companies, now up 9.3% for the year after languishing in negative territory for much of the year. International equities continued to lead the S&P 500, with the MSCI EAFE (Europe, Australia, Far East) index up 22.3% year to date and European equities finishing up 27.2% at the end of the third quarter. Gold continued its record run even with the strong performance in equities, setting new records at over $3,800/ounce, gaining 17% in the third quarter alone and 47% year to date.

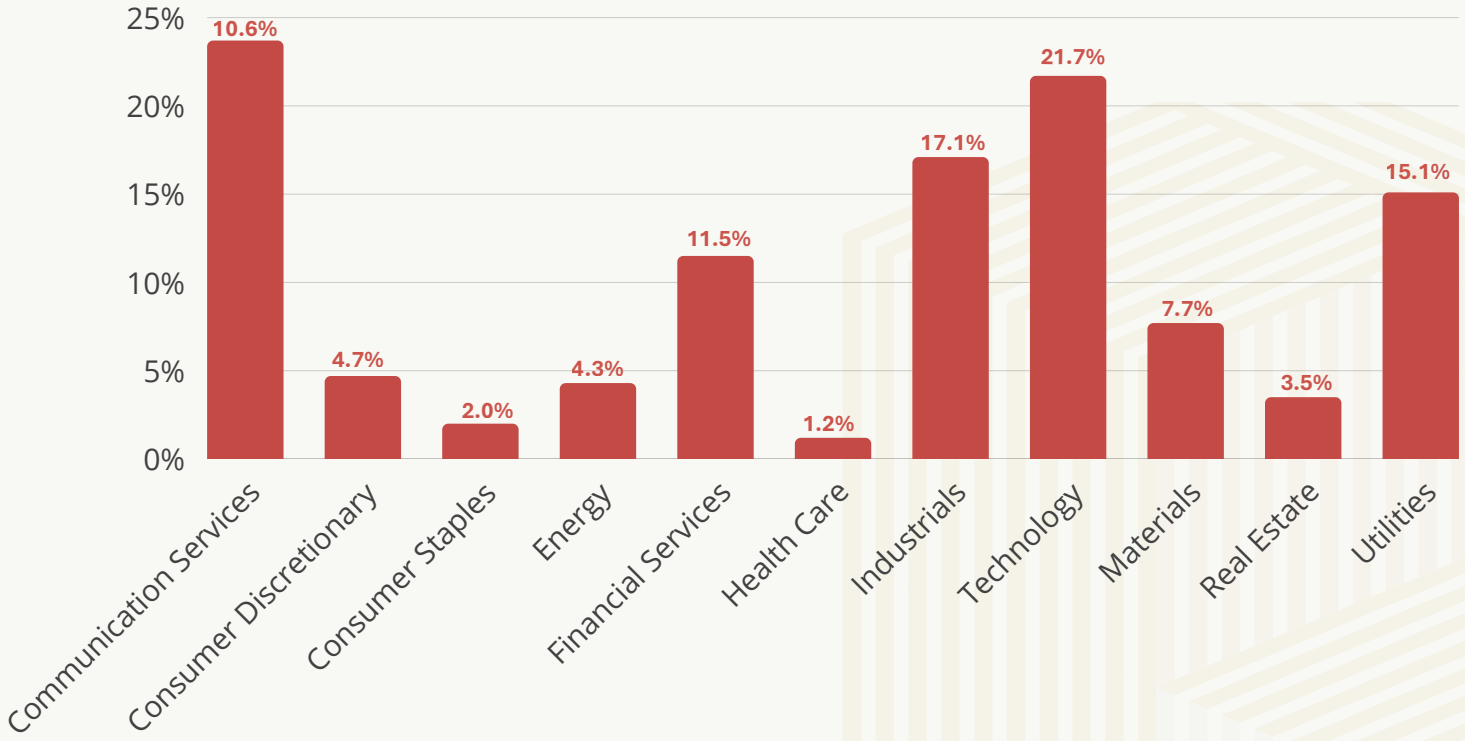
The technology and communication services sectors solidly returned to growth leadership, with gains of 12.4% and 12.8% respectively in the third quarter. Consumer discretionary gained another 8.9% as U.S. consumer spending has proved resilient. One of the worst-performing sectors in the second quarter, healthcare, recovered ground in the third quarter, gaining 4.5%. Industrials gained 6.3% in the quarter on renewed enthusiasm for AI that promises continued demand for power-hungry data centers and the equipment to run them. Energy finally saw an uptick in investment after underperforming much of the year, gaining 5.8% in the quarter and utilities powered ahead 7.8%.

While the job market has been softening with a slower pace of

3Q25 YTD MAJOR INDEX PERFORMANCE



3Q25 YTD SECTOR PERFORMANCE



hiring, unemployment still remains relatively low and disposable income has held up. There are some signs the consumer is feeling stretched: delinquencies on subprime auto loans are at historically elevated levels and mass market retailers and restaurants are seeing consumers trade down to economize. Over two-thirds of the U.S. economy is driven by consumer spending. We track employment data, income, debt, interest rates and inflation rates to gauge the health of households and by extension, the health of the U.S. economy.

Unemployment has ticked up slightly over the past quarter but remains low at 4.3%, disposable income is up 4.7% vs. a year ago, and the pace of retail sales picked up, increasing 4.8% compared to last year. Many of these indicators are backward looking- they won't tell you what is going to happen in the future, but weakening trends can provide some insight into the direction of the broad economy.

Both global and U.S. economic forecasts have been revised downward since the beginning of the year, due to the impact of tariffs. Global GDP is forecast to grow at 2.3% in 2025, down from 3.2% at the beginning of the year. U.S. real GDP is now forecast to grow 1.6% in 2025, up slightly from 1.4% previously but down from 2.1% at the beginning of the year. The drag on economic activity created by tariffs, which are a tax on trade, has tempered GDP forecasts.

Company earnings reports for the second quarter came in strong, largely meeting or exceeding expectations. As a result, the combined earnings estimate for all of the companies in the S&P 500 is now $257.99 in 2025, down modestly from $266.39 in the first quarter. This would be an 11% increase from $233.35 in 2024. For comparison, earnings grew 8.4% in 2023 over 2022 and 9.3% last year. The earnings outlook for 2026 is even more robust, calling for 17% year-over-year growth.

The 10-year Treasury yield ended the quarter at 4.16%, following a widely-expected 0.25% rate cut in September. Inflation has ticked up to 2.9%, the fastest increase since January and largely attributed to upward price pressure for

consumer goods as a result of tariffs. This puts the Fed in the difficult spot of balancing its mandate of keeping inflation under 2% while the labor market is showing signs of softening.

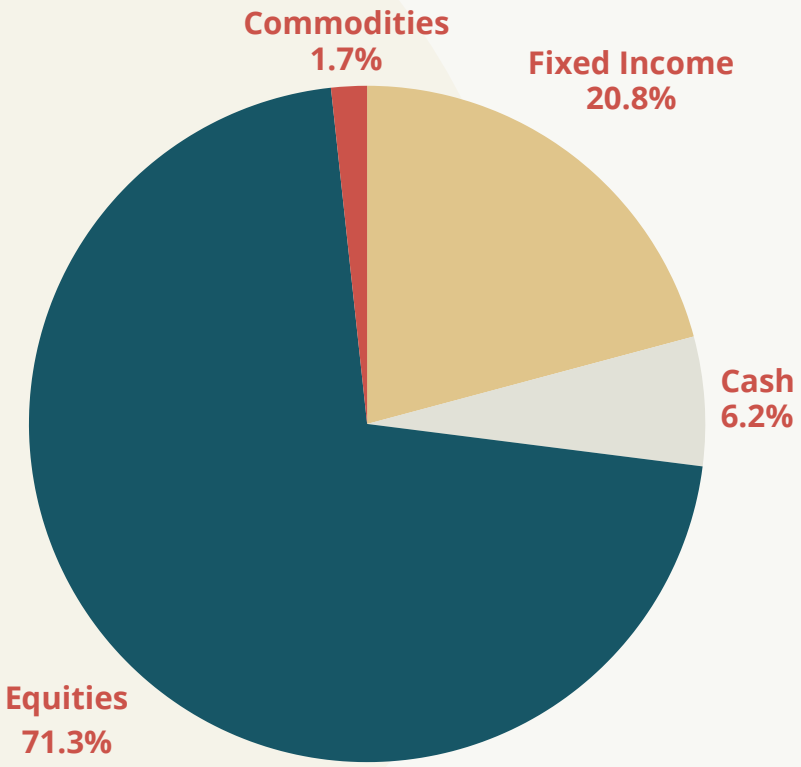
Mortgage borrowers finally saw some relief and 30-year fixed mortgage rates decreased to 6.3% from 6.8% in the quarter. The fall in rates has spurred refinancing activity from homebuyers who bought when rates were in the 7% range and breathed new hope into the housing market, although we are now entering the seasonally slower time of the year for real estate.

The U.S. Aggregate Bond Index is now up 6.1% for the year, a strong showing for fixed income. The market is already assuming that we get another quarter point rate cut in October, which supports bond prices. Firmwide, we ended the third quarter with 8% of assets in cash and gold, 21% of assets in fixed income securities, and 71% in equities. We are positioned to take advantage of the potential for continued earnings growth and appreciation, while taking precautions for a U.S. equity market that is relatively expensive by increasing allocations to international stocks and fixed income.

WE MANAGE SEPARATE ACCOUNTS FOR EACH OF OUR CLIENTS. EACH PORTFOLIO IS CUSTOM TAILORED FOR THE CLIENT

GKV FIRMWIDE

Asset Allocation



The Stock Market is Not the Economy

At the beginning of the year, our outlook for U.S. equities was not terribly optimistic. After two consecutive years of more than 20% gains, we were concerned that earnings growth may not measure up to lofty expectations. Although the rise and fall of stocks can frequently appear capricious, there is typically a fundamental underpinning to justify equity market valuations. That doesn't mean that the assumptions being used to value stocks are correct, however. Expectations can get carried away or are simply unjustified. Occasionally some crisis develops out of financial excess, forcing a correction back to reasonable fundamentals. In our view, at the outset of the year, stocks were valued at a premium based on an optimistic earnings outlook.

Heading into 2025, Wall Street analysts were anticipating corporate earnings for the S&P 500 to increase by 16%. That kind of earnings growth is more typical of an economy emerging from a recession rather than one several years into an economic expansion. And this forecast was an acceleration from already strong growth of 8.4% in 2023 and 9.3% in 2024. We thought the forecast to be aggressive and anticipated a necessary reduction in expectations. Coming into the fourth quarter, the earnings estimate for 2025 has been revised downward but is still very positive at 10.4% growth. Furthermore, the forecast for 2026 calls again for an earnings acceleration of 17%. In typical Wall Street analyst fashion, the estimates in the near-term are reduced while the long-term forecast remains optimistic enough to justify the recent rise in stock prices.

Earnings have been positive enough to move stocks higher for the first three quarters of the year. The outlook going forward will continue to depend on earnings growth as we move into 2026. Meanwhile, the financial news cycle has been more chaotic than ever. The Silicon Valley ethos of "move fast and break things" seems to have been coopted by the Trump Administration. Whether one agrees or disagrees philosophically with the policies, no one can accuse the administration of standing idle. From DOGE to Liberation Day, on and off and on-again tariffs, immigration raids, fired officials, and weakening unemployment data combined with stubborn inflation have all provided a constant distraction for investors. More discipline than ever is required to decipher what is likely to impact the markets and what is simply noise. It is very easy to get caught up in the headlines or the sensationalism of social media. Unless there is likely to be a material impact on future earnings, as far as the stock market is concerned, headlines should be ignored. This includes geopolitical conflict, political polarization, government shutdowns, Federal Reserve independence and to some extent, even the health of the U.S. economy. We aren't saying that these things don't matter. They just don't matter that much in the valuation of your stocks.

EARNINGS HAVE BEEN POSITIVE ENOUGH TO MOVE STOCKS HIGHER THE FIRST THREE QUARTERS OF THE YEAR.

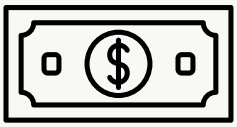
For our clients, whenever we calculate account performance data, we also show the performance of the S&P 500 index. If the stocks in a portfolio are significantly worse than the performance of the index for long periods of time, an investor should probably look for a new portfolio manager.

After the first three quarters of this year, the S&P 500 is up 13.7%. It has been a very good year. In fact, the last few years have been fantastic for stocks. The S&P 500 gained 23% in 2024 and 24% in 2025. Makes it easy to forgive the 19% loss in 2022.

When the market hits a new high, there is propensity to assume that the next market move will be lower. While there will be market corrections and periodic financial crisis precipitating sharp declines, the long-term trajectory of the broad equity markets is higher. So far, in 2025, the S&P 500 has closed at a new high on 20 separate trading days. New highs frequently lead to further new highs. In 2024, the S&P 500 closed at a new high on 57 days. In 2021, the index closed at all-time highs on 70 days. That averages to a new high on every third trading day.

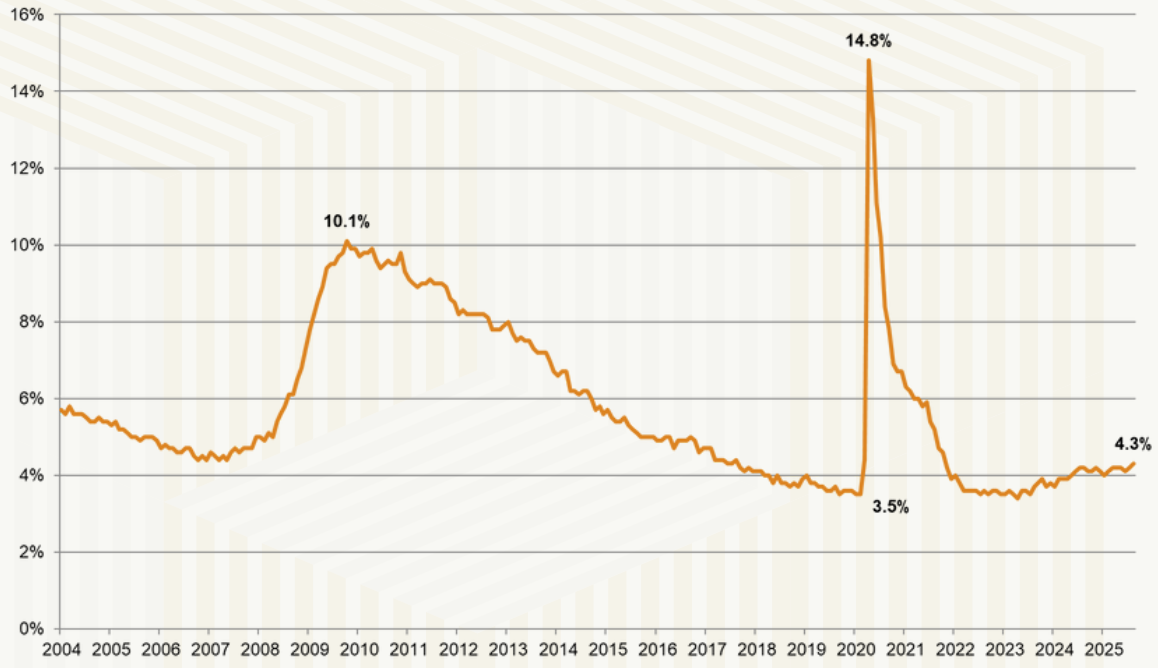
The index is made up of many individual stocks, and the performance of those stocks can differ significantly from the overall index. Ultimately, individual stocks are valued on the rising and falling expectations of future cash flows. Poorly performing companies are periodically removed from the index, and they are replaced with up-and-coming new companies that are growing. If the companies that comprise the index are growing earnings, the index can continue to hit new highs over time. Of course, these gains do not always occur in a straight line, but there is good reason that over the long-term, stocks have been and continue to be very reliable investments.

THE U.S. DOLLAR IS DOWN 10% YTD



GOLD IS UP 47% YTD

»U.S. UNEMPLOYMENT RATE SINCE 2004



Bureau of Labor Statistics September 2025

THE U.S. ECONOMY AND THE STOCK MARKET

Even though economic growth has slowed this year, the stock market has continued to record new highs. This seems counterintuitive, but the stock market is not a measure of the economy. A significant economic downturn will likely impact corporate profits broadly, so it is important to be in tune with the direction of the economy. However, the economy and the stock market can move in different directions for extended periods of time. The U.S. economy is very large, comprising of more than 30 million businesses. As we pointed out earlier, the S&P 500 only includes the 503 largest publicly traded companies. It is generally more difficult for companies to grow as fast in a weak economic environment, but that is not always the case. Looking at earnings and earnings growth expectations is the best indicator for any individual stock. A deep recession would certainly have an impact on sales and earnings for most companies, including those in the S&P 500, but we currently see little chance of even a slight recession.

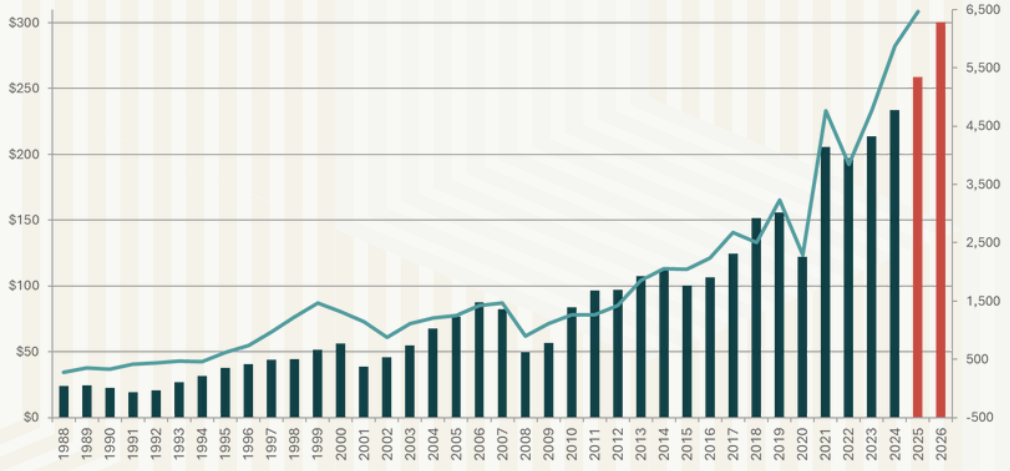
We track economic data carefully and then use broad economic expectations to determine whether we believe earnings expectations are reasonable. We pay a lot of attention to unemployment simply because if too many people are out of work, less money can be spent on goods and services, resulting in lower sales and corporate profits. For similar reasons, we track household income and retail spending to get a gauge of how the consumer is actually doing. Headlines may feel negative or sentiment may be low, but (again) they have little impact if we are all still earning and spending. Two-thirds of the overall U.S. economy is driven by consumer spending, so the health of the consumer is important.

The U.S. unemployment rate hit a recent low of 3.5% back in January 2023. Since then, the figure has been slowly moving higher, reaching 4.3% in August. The pace of new job creation has slowed, and the figures are compounded by the ratcheting up of immigration enforcement making workers hard to find in some sectors that have traditionally been served by illegal labor.

Wage growth has been tracking slightly faster than inflation, which is positive for the health of the consumer. Inflation is running at about 3% and wage growth is about 4% resulting in nominal wage growth of approximately 1%.

The biggest question for the U.S. economy in 2025 is how significant the impact of tariffs will be. Tariffs don't seem to have had a significant impact on prices so far. Many importers are absorbing the additional costs, but that won't last, in our view. The outlook for the overall economy is uneven. This uncertain outlook creates some risk as to what continues to be an optimistic earnings outlook into 2026.

»S&P 500 EARNINGS GROWTH AND INDEX PERFORMANCE 1988-2026 ESTIMATED



INTEREST RATES AND THE FEDERAL RESERVE

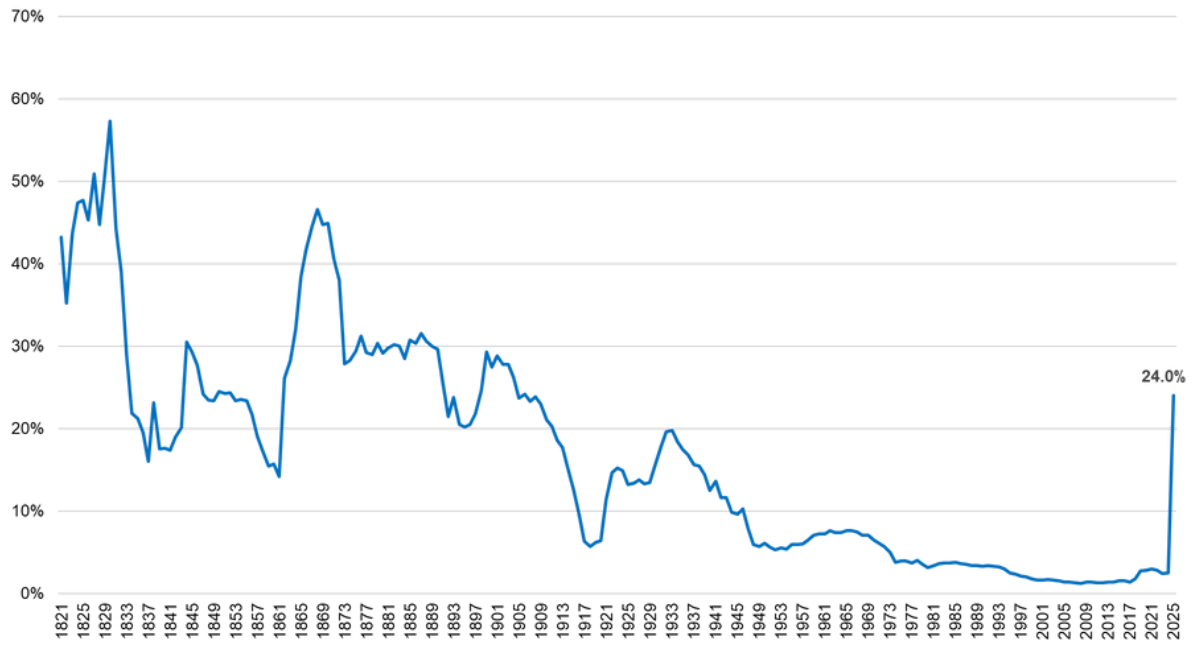
Last month, financial news commentary was largely focused on the Federal Open Market Committee meeting and a much-anticipated cut to interest rates. As expected, on September 17th, the Fed Funds Rate was cut by 0.25% to an upper limit of 4.25%.

The FOMC meeting was noteworthy for several reasons. This was the first interest rate cut this year. There were several cuts in 2024 from a high of 5.5%, but the Fed Funds rate has held steady at 4.5% for the last nine months due to the prolonged inflationary environment. During the pandemic, rates worldwide were pushed down towards zero to spur economic growth. While the effort to bolster economic growth was largely successful, the unprecedented economic stimulus of low interest rates coupled with direct payments to businesses and consumers generated the most inflation since the oil shock of the early 1980s.

And then there was the drama of the Trump administration's attempt to fire Federal Reserve Governor Lisa Cook in a bid to influence a greater reduction in rates from the traditionally independent Federal Reserve. What is most ironic is that after the cut back in September, key interest rates have actually moved higher. While the Federal Reserve can set the overnight Fed Funds rate, rates of interest for everything from U.S. Treasurys to consumer mortgages are set by supply and demand in the market.

The Fed Funds rate determines the rate banks can borrow at using the Federal Reserve overnight facility. This lending rate has a trickle-down effect for the rest of the market. Unlike communist China, the Federal Reserve does not dictate interest rates. Interest rates are set as a function of supply and demand. If investors believe that the yield for 10-year U.S. Treasury bonds yielding 4.2% is attractive, they will buy them. If there is enough demand, the price will increase, and the yield will fall to a lower rate.

»AVERAGE U.S. IMPORT TARIFF RATE SINCE 1821



Bureau of Economic Analysis, August 2025

LOWER INTEREST RATES ARE UNLIKELY TO HELP

Investors in U.S. government debt have more concerns of late than they have had in the past. Inflation remains elevated at 3%. High inflation keeps the Federal Reserve from cutting rates aggressively. Additionally, the U.S. dollar has been weak this year, down 10%, which makes U.S. Treasurys less attractive for foreign investors. The significant budget deficits that are likely to grow in coming years due to the massive tax and spending bill passed earlier this year will also keep rates elevated.

Furthermore, the markets discount rate cuts long before they happen. Usually, a rate cut catches up to what the market is already anticipating. The 10-year Treasury note was yielding 4.04% on September 16th. At the end of the quarter, on September 30th the 10-year treasury yield was 4.16%, an increase of 0.12% despite the Fed's quarter point cut on September 17th. Currently the market is placing the probability of a 0.25% rate cut in October at 85%. Unless the Fed does something wholly unexpected, such as a 0.50% rate cut, current bond and mortgage rates already reflect an October cut. For investors, the reason for a rate change is more important than the actual change itself. The Federal Reserve has a dual mandate to balance maximum employment and price stability.

Lower interest rates enable businesses and consumers to borrow more capital at a lower cost. The additional capital increases investment and consumption, increasing economic growth and frequently reducing unemployment. If too much capital is thrown into the economy, demand outstrips supply, wage costs accelerate, and inflation increases. High inflation will rapidly impair meaningful economic growth and can lead to dramatic economic boom and bust cycles if left unchecked.

Everyone would like faster economic growth, but not at the long-term cost of high inflation or another Great Depression. We welcome reductions in interest rates but want to be sure that inflation will not accelerate. This is the reason Congress created a politically independent Federal Reserve.

Currently, the economy is moving toward a scenario where unemployment is gradually increasing, necessitating lower interest rates. At the same time, the August inflation rate of 3.1% is above the 2% target, making it harder to justify a rate cut.

To further complicate the picture, tariffs are likely to increase inflation, but the magnitude of the impact is uncertain. Some companies will be able to absorb a portion of the additional costs but will sacrifice profits in doing so. Whatever is not absorbed will be passed on to the consumer as a price increase.

While interest rate changes can have an impact on stock prices, the impact on credit markets and bond prices is more significant. As rates come down, the prices of bonds increase. For example, say you buy a 10-year Treasury bond at $1,000 with a 5% coupon. If rates for 10-year Treasury bonds subsequently decline to 4%, the bond you bought will be priced at $1,080 for an equivalent yield of 4% (you'll have to trust our math). You can choose to hold the bond and continue to collect 5% annually, or sell the bond, pocket the 8% gain and redeploy the assets elsewhere.

With generally declining interest rates, the performance of bonds has been nearly as strong as stocks. The Aggregate Bond Index is up 6.1% for the first three quarters of this year. And like U.S. stocks, corporate bonds are also expensive. U.S. Treasury bonds are the closest thing to a risk-free investment. The U.S. Federal Government is unlikely to default on its debt. Investment-grade corporate bonds are currently paying only a 0.74% premium over U.S. Treasury yields, meaning investors are willing to get paid very little for the increased risk of a corporate bond over U.S. Treasurys. And junk-bonds, which have a considerably higher risk profile, as the name suggests, are only paying 2.75% more than similarly dated U.S. Treasurys. To us, the prospect of making less than 5% by investing in bonds is not terribly exciting, but bonds remain the best tool for diversifying from the volatility of equities.

If the 2026 earnings growth forecast of 17% holds true, stocks can continue to move higher. This forecast will depend on a Goldilocks combination of good economic data, a slowdown in unemployment and an improvement in inflation enabling continued growth and reductions in interest rates.

We anticipate that the massive investment in artificial intelligence will continue unabated. The technology and communication sectors are becoming an ever-bigger percentage of the S&P 500. The technology sector now makes up more than 25% of the total earnings of the S&P 500 and represents 34% of the market capitalization of the entire index. Earnings for the technology sector are also growing the fastest, estimated to increase 25% in 2026 over 2025.

U.S. equities are expensive at 22x 2026 estimated earnings. To use the exact words of Fed Chairman Powell, equity prices are "fairly highly valued". With some time and continued positive earnings results the premium valuation can be reconciled, but the risk of a sharp correction with any slowdown is high. There is a lot of cash chasing limited investment opportunities, however. Investment concentration into companies that are growing earnings is also likely to continue. Expensive stocks can get even more expensive.

To mitigate risks, we are actively looking to further diversify our allocation from U.S. equities into fixed income, foreign large cap equities and precious metals.

Since the financial crisis in 2008, growth in the U.S. has far outpaced the rest of the developed world. While U.S. growth is still expected to continue to exceed most geographies, select non-U.S. companies are trading at a comparative value. We have significantly increased our allocation to non-U.S. equities this year. European large cap stocks are trading at 14.3x 2026 estimated earnings. The comparatively low valuation to U.S. equities considers the considerably slower growth rate. Earnings growth for European equities is expected to reach only 5% in 2025 and accelerate to 11% in 2026. We expect to continue to allocate more towards non-U.S. equities as we move toward the end of the year.

The threat of tariffs, growing federal deficit spending, slowing growth, and lower interest rates are all pushing the U.S. dollar lower. A declining dollar coupled with elevated inflation has increased investment in commodities and in particular precious metals. Gold is up 47% year-to-date and we expect to also increase our asset allocation toward commodities.

There is a tremendous amount of noise- from TikTok predictions of a crash, political extremists warning dire consequences, get-rich-quick scams posing as prudent investment advice. It's appropriate to worry about your financial wellbeing but make sure you aren't fixating about the wrong things when it comes to your portfolio. Economic growth is important. Stay grounded in actual data rather than anecdotal evidence. Earnings and their forward expectations are more important than anything else. Evaluate changes to your investment thesis through the lens of what the potential impact to future earnings will be.

Be diversified. Every asset class, including stocks, bonds, commodities, crypto, real estate and even private equity will have their own cycles. Everything can lose money from time to time. And unfortunately, while diversification can reduce risk, in a crisis, everything is correlated.

Adjustments in asset allocation should be made as the situation warrants. As fixed income investments pay more interest it makes sense to take some profits from stocks and reallocate. Different industries and investment theses will move in and out of favor. If you chase performance, you will always be behind. Well-run companies that are growing at reasonable valuations will continue to produce gains over time.

BUILD YOUR WEALTH

To Fund Your Passions

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Client accounts are separately managed and tailored to meet the specific needs, including risk tolerance, investment objectives, and tax consequences of each client. Client assets are held at an unaffiliated brokerage firm.

With extensive expertise in security analysis, we make direct investments on behalf of our clients buying individual securities. This eliminates costly mutual fund fees and increases the flexibility to manage volatility. We actively allocate capital to take advantage of investment opportunities altering exposure to individual companies, industry sectors, and asset classes in anticipation of the changing investment and economic environment.

We are transparent in all facets of our asset management practice and believe it is important for our clients to know what they own, why, what their performance is, and what they are paying in fees. We build comprehensive portfolios for our clients with a goal of reducing volatility and producing prudent growth.

We protect and build wealth at GKV Capital.

GKV CAPITAL

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