



3Q25 Market Review: Against Perfection

Shaking off the second quarter's volatility, equity markets marched steadily higher throughout the third.

Though uncertainty remained in ample supply during the summer, stocks continued to rebound off their April "Liberation Day" troughs as investors cheered continued artificial intelligence (AI) spending and the prospect of Federal Reserve easing. For the quarter, the S&P 500 Index gained 8.1%, led to new record highs by the market's tech-oriented growth names. While the MSCI EAFE Index's 4.8% advance during the quarter lagged that of the US benchmark, it maintains a year-to-date advantage of more than 1,000 basis points.¹

At the risk of sounding like a broken record, we'll again note the apparent disconnect between the risk perception evident in US markets—as illustrated by rich equity valuation multiples, tight high yield spreads, low implied volatility and a price ratio of growth to value stocks near all-time highs—and the many existing vulnerabilities with the potential to metastasize into something more broadly disruptive.² It seems to us that such an environment may be particularly susceptible to disappointment amid even modest shifts in sentiment.

KEY TAKEAWAYS

- US equity market valuations appear full, but a number of factors have impacted positive nominal drift to the economy and helped support earnings expectations.
- Constructive dynamics have emerged in non-US economies, beckoning the return of animal spirits and driving the relative outperformance of non-US equities year to date.
- Gold and equities, unusually, have surged together in recent quarters, drawing comparisons to previous incidents of this dynamic—such as the early 1970s before the onset of stagflation.
- In a world brimming with risk, US markets seemingly priced for perfection may be more susceptible to disappointment than non-US markets with more normal valuations.

1. Source: FactSet; data as of September 30, 2025.

2. Source: Bloomberg; data as of September 30, 2025.

Animal Spirits Reemerge Outside the US

While we think it's fair to characterize the appetite for risk in the US as full, that's not to say market prices have no foundation in reality. Earnings growth forecasts remain constructive, driven by factors ranging from the impact of the AI capex cycle to fairly accommodative fiscal conditions. In terms of the latter, the rate of growth in government spending and the size of its debt continue to exceed wage growth, imparting some positive nominal drift to the economy that has trickled down into expectations for corporate earnings and margins expectations. At the same time, short-term interest rates have moved lower following September's widely expected 25 basis point reduction in the federal funds rate, and markets are pricing in an additional 50 basis points of cuts by year-end.³

Similarly constructive dynamics have emerged in non-US economies, beckoning the return of animal spirits to markets sorely in need of a boost and helping to drive the relative outperformance on non-US equity markets year to date. In Europe, for example, Germany has taken steps to leverage its ample fiscal capacity, notably on defense and infrastructure projects,⁴ and NATO countries as a whole agreed to raise annual defense spending to 5% of GDP by 2035.⁵ China's multiyear debt-restructuring initiative for local governments—earmarked at 12 trillion yuan—appears to be bearing fruit and has enabled local authorities to clear arrears to suppliers rather than debt service.⁶ In Japan, the country's likely next—and first female—prime minister has a reputation as a pro-spending conservative who also favors stimulative monetary policy.⁷

Constructive dynamics that have emerged in Germany, China and Japan may help drive the relative outperformance of non-US equity markets.

Considerable weakness in the dollar over the course of 2025—the ICE US Dollar Index is down nearly 10% year to date—has further supported the outperformance of non-US equity markets. Still, it wasn't until this year that the MSCI EAFE broke through its 2007 peak.⁸ The MSCI EAFE is trading around 17x trailing earnings—not cheap but well within the realm of normal, from our perspective, and certainly less rich than the S&P 500's 28x.⁹ And while it has pulled back marginally, the price ratio of US equities to non-US stocks stands at more than 2.5 times the average since 1970.¹⁰

Unusually, Gold and Equities Have Surged in Tandem

An interesting feature of the financial markets over the past several quarters has been the concurrent rally in equities and gold prices. Gold's year-to-date gain of nearly 50% puts it on an annual pace not seen in nearly 50 years, as central banks and investors alike have piled into the metal amid elevated risks and the potential for currency debasement. More recently, we've also seen other precious metals—including silver and platinum—break out to the upside.¹¹

Historically, equities and gold have both participated in the nominal drift of the global economy, but they typically have done so in a countercyclical manner, as gold has tended to thrive in conditions less supportive of equity investment. There have been exceptions, however, perhaps most notably during the early 1970s. This period was characterized by the fiscal pressures of the Vietnam War, the end of the Bretton Woods gold peg and executive branch pressure on the Fed to ease interest rates despite inflation pressures, a combination of factors that contributed to monetary disequilibrium and a ultimately decade of stagflation.

3. Source: CME FedWatch; data as of October 10, 2025.

4. Source: Reuters; data as of March 21, 2025.

5. Source: NATO; data as of June 27, 2025.

6. Source: Bloomberg; data as of April 16, 2025.

7. Source: Bloomberg; data as of October 4, 2025.

8. Source: YCharts; data as of September 30, 2025.

9. Source: FactSet; data as of September 30, 2025.

10. Source: Bloomberg; data as of September 30, 2025.

11. Source: Bloomberg; data as of September 30, 2025.

While we don't want to overstate the historical analogies, there are some evident parallels between that period and the current environment, including the fact that the US appears to be a long way from home base in terms of monetary and fiscal settings. For example, we wouldn't expect the federal government to be running at a substantial fiscal deficit over the past several years of sub-4.5% unemployment—including just shy of 6.0% of GDP in the recently completed fiscal 2025.¹² Meanwhile, Trump is pressuring the Fed to lower the federal funds rate while the fiscal imbalance remains unaddressed and geopolitical tail risks have only grown fatter.

Tending the Garden

Strong markets can create a dilemma for portfolio managers; while you want to let your roses bloom, you must remain true to your investment discipline. It also creates favorable conditions for recycling capital, however, by trimming more successful positions to take advantage of emerging opportunities in sectors or geographies that have been out of favor.

Of course, the world remains rife with risk, including massive sovereign debt loads, geopolitical frictions and political strife. While an increase in the market's appreciation of these risks would likely impact both US and international stocks, current valuations suggest that international markets in general are priced with lower expectations and thus may be less susceptible to disappointment should these latent vulnerabilities blossom.

Strong markets can create a dilemma; while you want to let your roses bloom, you must remain true to your investment discipline.

12. Source: Bloomberg; data as of October 9, 2025.

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All investments involve the risk of loss of principal.

A principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value. "Value" investments, as a category, or entire industries or sectors associated with such investments, may lose favor with investors as compared to those that are more "growth" oriented.

There are risks associated with investing in foreign investments (including depository receipts). Foreign investments, which can be denominated in foreign currencies, are susceptible to less politically, economically and socially stable environments; fluctuations in the value of foreign currency and exchange rates; and adverse changes to government regulations.

Investment in gold and gold-related investments present certain risks, and returns on gold related investments have traditionally been more volatile than investments in broader equity or debt markets.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Federal funds rate is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis.

Gross domestic product (GDP) measures the total value of all economic output in goods and services for an economy.

Sovereign debt is issued by a country's government as a way to borrow capital.

Indexes are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

ICE US Dollar Index is a geometrically averaged calculation of six currencies weighted against the US dollar maintained by ICE Futures US.

MSCI EAFE Index (Net) measures the performance of large and midcap equities across developed markets countries around the world excluding the US and Canada. A net-return index tracks price changes and reinvestment of distribution income net of withholding taxes.

S&P 500 Index (Gross/Total) measures the performance of 500 of the top companies in the leading industries of the US economy and is widely recognized as a proxy for the US market as a whole. A total-return index tracks price changes and reinvestment of distribution income.

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