

INVESTMENT PERSPECTIVES

SEPTEMBER 2025

Key Takeaways —

- Possibilities for European equities.
- Understanding inflation dynamics.
- September's cautionary market tone.

**A BOOSTER SHOT FOR EUROPE ■**

Mark Luschini, Chief Investment Strategist

Germany is the biggest economy in Europe and one of the top five largest in the world. Consequently, the state of its economy has a huge influence on the health of Europe overall.

In summary, we believe that recent measures taken by German policymakers will fuel activity, allowing growth to accelerate and provide a positive impulse throughout the Euro area. This thesis reinforces our conviction that European equities can continue to build on their already impressive advance this year and deliver solid gains for U.S. investors going forward.

Officials in Berlin are embarking on an era of fiscal expansion. A stimulus equivalent to approximately 1% of GDP is primed to be released, helping to boost business and investor confidence despite unease about the tariffs applied to goods that Germany exports to the U.S. (a non-trivial 3.2% of GDP). The Expectations Index by the Ifo Institute, a measure of German business expectations that tends to correlate well with future economic conditions, posted a reading in August that was the highest since 2022. Additionally, the monthly investor sentiment poll reported by the ZEW (a.k.a. Centre for European Economic Research), while having pulled back in August, was at its highest level in more than three years as recently as July. From a monetary perspective, financial conditions are easing due to the series of rate cuts undertaken by the European Central Bank, as inflation has subsided to a level approaching its target of 2%. This has also helped narrow the spread between German corporate bonds and sovereign bonds (the Bund), which in turn reduces borrowing costs for companies.

Finally, falling energy prices are a tailwind for businesses and consumers alike who had grappled with the burden of high oil and natural gas import prices in the aftermath of

Russia's invasion of Ukraine. Together, the forthcoming improvement in Germany's economy is expected to spill over to other Euro area countries, leading to sustained expansion. To be sure, the current 15% tariff that the U.S. has imposed and applied broadly to Europe's exports, plus the 50% levy on steel, aluminum, and copper, will hurt trade and shave perhaps a few tenths or more off GDP. However, with concurrent stimulus measures and improved consumer and business sentiment supporting organic growth, the overall economic picture should brighten.

Indeed, what Germany is undertaking is being promulgated by the President of the European Commission (EC), Ursula von der Leyen. Today, many member countries are seeking relief from their budget constraints to expand spending on infrastructure and their military operations. To that end, the EC is providing a pool to enable members to borrow, allowing them to meet their defense spending targets and invest in new capital projects. The EC's ReArm Europe campaign earmarks \$840 billion to be available for member countries to help meet NATO's increased spending target of 3.5% of GDP for core military needs by 2029. Today, only Poland meets that target by spending 4.1% of its GDP.

Furthermore, the widely circulated report delivered by former European Central Bank President Mario Draghi in 2024 advances the need for greater fiscal and monetary integration across the 19 members of the Eurozone. In striving for greater European competitiveness, he expressed an urgent call for "far more coordinated industrial policy, more rapid decisions, and massive investment" to keep pace with the U.S. and China economically. It also heavily emphasized, among other things, the need for greater cross-border coordination, including reducing regulations, increasing productivity, and aggregating capital markets activity. European officials are taking strides to address these issues, but in the meantime, Germany's massive fiscal booster shot will

awaken what had been the historically sclerotic European community. As we have consistently written and stated over the past nine months, investors seeking to diversify risk-based capital should consider allocating to European equities. While that has clearly been rewarding over this duration, the secular change afoot gives reason to believe there remains great potential to build on these gains for a long time to come. ■



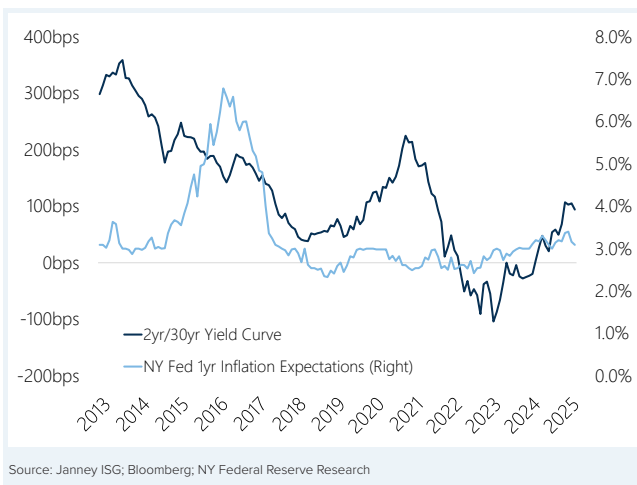
EXPECTATIONS AND INTEREST RATES

Guy LeBas, Chief Fixed Income Strategist

Inflation in the United States has remained modestly above the Federal Reserve's 2% benchmark, supported by recent price data that continues to challenge expectations of a disinflationary lull. According to the BEA, the core PCE—the Fed's preferred gauge—stood at +2.9% year-over-year in July after two notable upticks, in part from the lingering pass-through of elevated tariffs. It remains unclear whether these price increases are one-time or ongoing in nature. Our base case is that tariffs will act more like a tax than a source of inflation, but the way we measure short-term data conflates the two.

Understanding inflation dynamics is essential for both economic stability and achieving optimal financial returns. On the demand side, inflation encourages timely consumption, while expectations of deflation have the opposite effect. On the supply side, inflation eases “wage rigidity” by allowing firms to maintain or freeze nominal wages—so real wages fall—without resorting to cultural job cuts.

Chart 1: Esp. Since 2022, Higher Inflation Expectations Have Resulted in a Steeper Yield Curve



The sustained below-target inflation over the past decade was once attributed to factors like a strong dollar, supply gluts, demographics, and sluggish global demand. Today's data tells a more nuanced story: tariffs are gaining traction in the price mix (notably in goods), while service pressures remain elevated. Across all asset classes, inflation expectations remain a principal driver of real returns. In 2025, markets have generally embraced the disinflation trend—long-term yields have fallen, and equity valuations are lofty, bolstered by resilient earnings and expectations of easing.

Reality is, of course, more complicated. In 2025, tariff-driven price increases have a uniquely recursive effect on inflation expectations. Unlike one-off supply shocks, tariffs are often viewed by consumers and businesses as policy-driven and therefore persistent, particularly if they are tied to longer-term trade or geopolitical agendas. This perception feeds into a self-reinforcing loop: as prices for tariff-affected goods rise, households revise their short-term inflation expectations upward, prompting earlier purchases or wage demands to preserve real purchasing power. Firms, in turn, may preemptively adjust prices to maintain margins against anticipated cost pressures. This cycle can amplify the initial inflationary impulse far beyond the direct mechanical impact of tariffs, embedding higher expectations into wage- and price-setting behavior—an outcome that complicates the Federal Reserve's task of guiding inflation back toward target without over-tightening policy.

Federal Reserve policymakers, meanwhile, find themselves in a delicate position. On the one hand, inflation remains above target; on the other, a softening job market and cautious sentiment are nudging toward stimulus. With core PCE at 2.9% and expectations still elevated, reasonable economists could readily disagree about which way the decision should fall. That said, political winds are clearly pushing policymakers to reduce interest rates sooner rather than later. Public rhetoric from the White House has been unusually aggressive on this basis; we expect the Fed to proceed with a 0.25% cut in September rather than a bold reduction. Market pricing supports this, with a high probability of at least a quarter-point cut, though renewed inflation signals could curtail more aggressive easing.

One possible outcome from the risk of a tariff-expectations loop alongside Fed rate cuts is the potential for a materially steeper yield curve. When investors believe that inflation will be higher in the future—whether due to tariff-related price pressures, supply-side shocks, or persistent demand strength—they demand additional inflation risk premium on longer-dated bonds. This drives long-term nominal yields up relative to short-term yields, steepening the curve. The term structure reflects not only expected future short rates but also compensation for the uncertainty around inflation outcomes, and given the unprecedented policy mix, uncertainty remains high. Meanwhile, Fed rate cuts drive down short-term yields, which can exaggerate any steepening.



THE IDES OF SEPTEMBER

Gregory M. Drahuschak, Market Strategist

Numerous measures of historic market activity underscore that September is typically the worst month for stocks, as the S&P 500 has ended the month higher on average only 25% of

the time. In the most recent 10 and 20 years, the S&P 500 posted an average loss for the month of 1.26%.

While September results have been less than stellar, they have not deterred the market from heading generally higher.

The reasoning behind September often producing a negative result is questionable. The end of summer vacation, expectations of a negative September result, end-of-the quarter portfolio adjustments, and funds taking

whatever losses they have before their fiscal year ends are all cited as reasons for September to be the worst month of many years.

While some or all of these issues might be present in any year and in many months other than September, the state of the economy tops all other factors. This was clear in eight of the 10 worst September results (1974, 2002, 2008, 2001, 2011, 1957, 1960, and 2000) as the economy was in a slowdown or was leaning toward potential weakness.

For example, a rapid rise in oil prices weighed on the economy in the early 1970s. 2001 and 2002 encompassed a recession. The Great Recession overwhelmed the economy and market in 2008. Economic struggles affected the market in 1957 and 1960.

Table 1: S&P 500 % Results in September

10 Best		10 Worst		Previous 10 Years		Previous 20 Years			
2010	8.76%	1974	-11.93%	2014	-1.55%	2004	0.94%	2014	-1.55%
1954	7.56%	2002	-11.00%	2015	-2.64%	2005	0.69%	2015	-2.64%
1998	6.24%	2008	-9.08%	2016	-0.12%	2006	2.46%	2016	-0.12%
1996	5.42%	1986	-8.54%	2017	1.93%	2007	3.57%	2017	1.93%
1997	5.32%	2001	-8.17%	2018	-0.43%	2008	-9.08%	2018	-0.43%
1950	4.85%	2011	-7.18%	2019	1.72%	2009	3.57%	2019	1.72%
2013	4.69%	1957	-6.65%	2020	-3.92%	2010	8.76%	2020	-3.92%
1958	4.29%	1960	-6.25%	2021	-4.76%	2011	-7.18%	2021	-4.76%
1973	4.01%	1981	-5.38%	2023	-4.87%	2012	2.42%	2023	-4.87%
1995	4.01%	2000	-5.35%	2024	2.02%	2013	4.69%	2024	2.02%

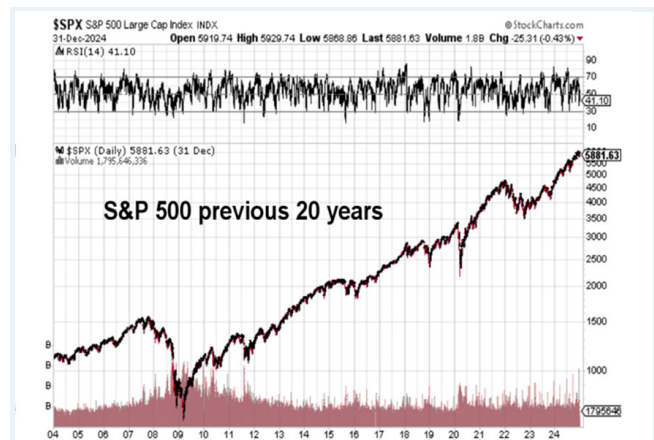
Source: LSEG T1; Janney Investment Strategy Group

Chart 2: S&P 500 Previous 10 Years



Source: StockCharts.com; Janney Investment Strategy Group

Chart 3: S&P 500 Previous 20 Years



Source: StockCharts.com; Janney Investment Strategy Group

The market enters this month with the prospect that the Federal Reserve might reduce the fed fund target range at the September 17, 2025, policy meeting. The Fed's Summary of Economic Projections, which provides the market with guidance on what the Fed believes the U.S. economy might look like in the coming months, will also be released at this meeting.

Corporate profits have been solid and notably better than expected, as recently as a few months ago. As August ended, S&P 500 companies had produced blended earnings growth of 11.7% versus the 4.9% expected at the end of the quarter, while 82% of reporting companies beat consensus earnings expectations compared with the 77% one-year average. Nonetheless, this all left the market at a relatively rich valuation.

It has been common for the current bull market to be characterized as the least-believed bull market on record. For example, bullish investment sentiment in the American Association of Individual Investors sentiment survey was more than 17% below its weekly average since 2020 and more than 20% below its all-time average. The percentage of survey respondents with a bearish market view hit 46.15%, which was 29% higher than the long-term average. Both measures are unusual in a period when the market is hitting all-time highs.

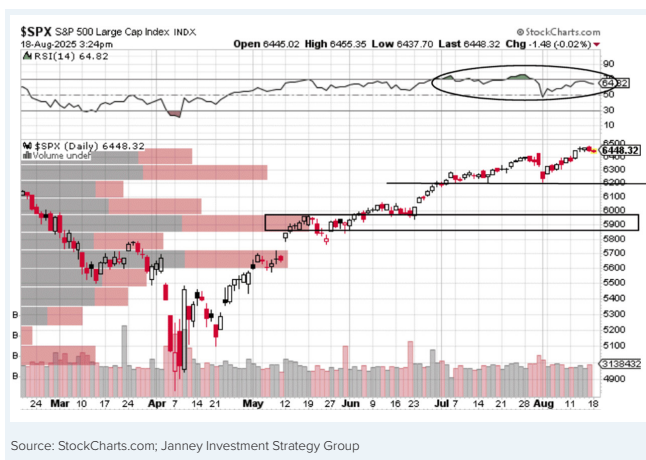
In our view, the greatest difficulty the market faces may stem from its own success.

By August 18, the S&P 500 had produced a precedent-setting 34.05% gain from its intraday low on April 7, 2025, to the intraday peak on August 15, 2025 (27.41% on a closing basis), all within 130 days. The speed of the advance and the stretched technical conditions it created leave the potential for a brief and shallow pullback, with various areas in the accompanying chart serving as levels of potential support.

After the late-June surge, the S&P 500 backed off and settled on a ledge of support at 6200, which functioned as a launching point for the most recent run to additional new highs (18 for all of 2025). As August ended, there was some commentary that the S&P was vulnerable to a 5%–8% pullback from its high. An 8% drawdown would drag the S&P to the middle of the 5900–6000 range highlighted in the chart. Before that, 6200 might provide enough support to stem a slide.

September dawns with a cautionary market tone. While a Fed rate cut might appear to alleviate concerns, it is widely expected already thanks to the Fed chairman's comments at the Jackson Hole symposium. In addition, the robust earnings season is now in the rearview mirror, and seasonal factors may take on a more prominent role. However, a moderate pullback that eases various concerns might set the stage for a decisive move out of the recently narrow trading range. ■

Chart 4: S&P 500 Large Cap Index



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