

2025 UPDATE

3rd Quarter Review



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The S&P 500 gained 7.8% in the third quarter, continuing its 2025 progress for a 14.8% year-to-date gain through the end of September. The Nasdaq Composite rose by 11.2% in the quarter, leading to a year-to-date gain of 17.9%, and the Dow Jones industrials rose 5.2% for 3Q and 10.5% YTD. In addition to the closely watched US large cap indices, the Russell Midcap was +4.9% for 3Q and +10.4% YTD, and the Russell 2000 (Small Cap) was +12% 3Q and +10.4% YTD. Major international indices were also strong for both periods, with the MSCI EAFE +4.2% for 3Q and +25.7% YTD and MSCI Emerging Markets +10% for 3Q and 28.2% YTD. The benchmark 10-Year treasury yield finished the third quarter at 4.13%, below the 4.58% level at which it began the year.

Financial Markets

As of 9/30/2025

Index	Level	MTD	QTD	YTD	1 Year	3 Year	5 Year
S&P 500	6,736.01	3.53%	7.79%	14.8%	17.6%	24.9%	16.5%
DJIA	46,453.61	1.87%	5.22%	10.5%	11.5%	19.6%	13.0%
Nasdaq Composite	22,996.19	5.61%	11.24%	17.9%	25.4%	29.9%	16.1%
Russell 2000	2,483.99	2.96%	12.02%	10.4%	10.8%	15.2%	11.6%
Russell 1000 Growth	4,781.30	5.26%	10.36%	17.2%	25.5%	31.6%	17.6%
Russell 1000 Value	2,017.16	1.31%	4.82%	11.7%	9.4%	17.0%	13.9%
Russell Mid Cap	3,880.75	0.72%	4.91%	10.4%	11.1%	17.7%	12.7%
S&P Mid Cap 400	3,266.62	0.29%	5.18%	5.8%	6.1%	15.8%	13.6%
MSCI EAFE	2,803.55	1.64%	4.23%	25.7%	15.6%	22.3%	11.7%
MSCI EM	1,372.04	6.96%	10.08%	28.2%	18.2%	18.8%	7.5%
MSCI ACWI EX-US	408.13	3.36%	6.35%	26.6%	17.1%	21.3%	10.8%
Bloomberg US AGG	2,328.62	1.09%	2.03%	6.1%	2.9%	4.9%	-0.4%
10 Yr US Treasury	4.13%	-	-	-	-	-	-

Source: Texas Regional Bank, Ycharts

THE QUARTER

The second and third quarters of 2025 were a period of surprisingly low equity market volatility given the national news-flow throughout. Israel directly attacked Iran on June 13, a dramatic escalation of a decades-long proxy war. The United States struck Iranian nuclear facilities with Stealth Bombers in the last weeks of June. The US National Guard was deployed to American cities by presidential order in June (Los Angeles), August (Washington D.C.), and October (Memphis). In September we were confronted with the first US political assassination in decades, one where the news traveled via horrific video. The war in Europe escalated, and war and hostage negotiations continued in the Middle East. Throughout these events, US equity markets didn't blink.

Gold and SPDR S&P 500 ETF



The financial news flow was complex as well. The Federal Reserve re-entered the easing cycle that it initiated in September 2024, despite strong markets, near record corporate margins, low unemployment, and inflation figures that remain above targets. Gold and bitcoin, two currency-oriented investments that often represent reduced faith in government or paper currencies, joined equity markets in making new highs.

Economic indicators were mixed, with the second and third quarters representing the 8th and 9th of an uninterrupted string of quarterly corporate earnings growth. Though employment growth has not been as strong as recent years, the unemployment rate remains low, with 4.2% to 4.3% reported between April and August, and the weakest part of the trend showing up in the 16-19 and 20-24 year old age classes, possibly due to some effect from artificial intelligence (AI) on the jobs that those age classes often fill.

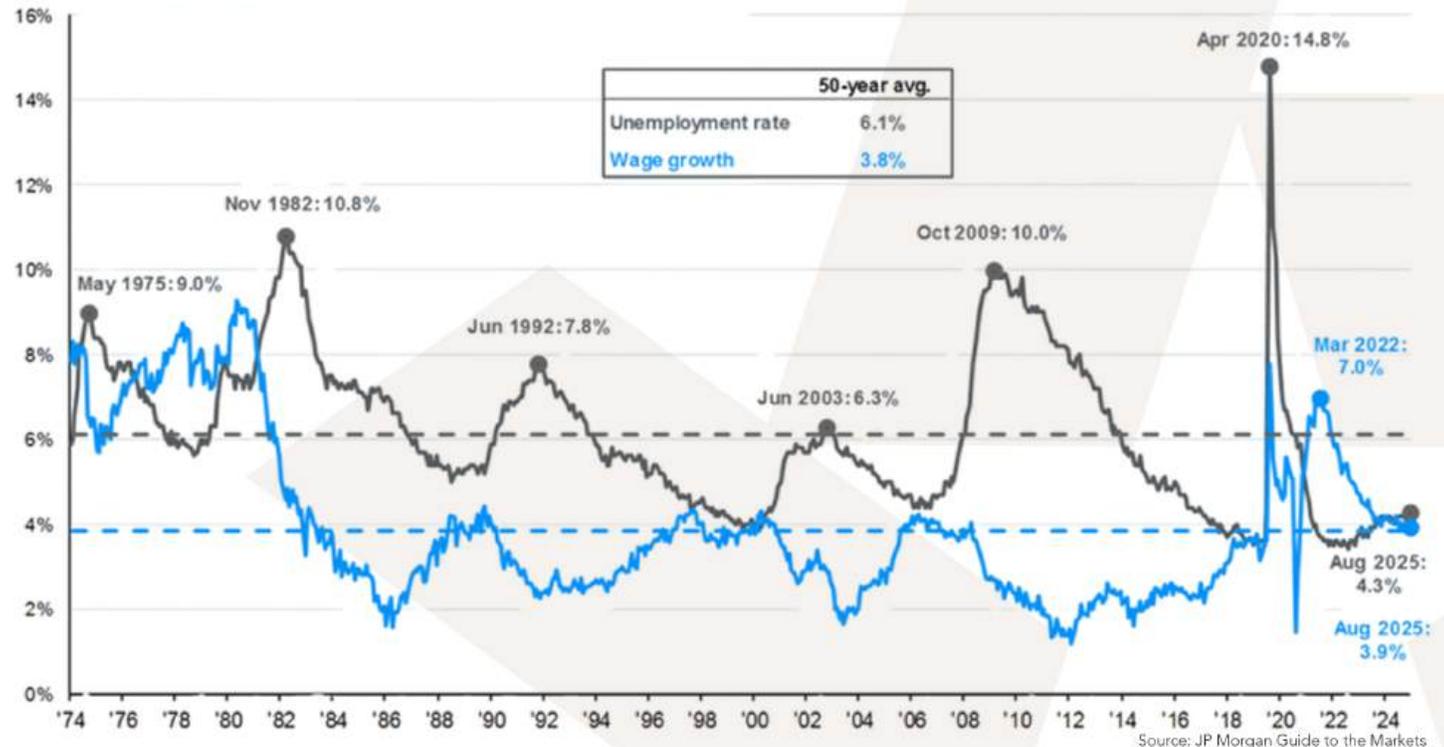
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THE QUARTER (CONT.)

Broad measures of economic activity such as US Services and Manufacturing Purchasing Manager Indices (PMIs) have deteriorated, oscillating near the 50 mark that divides economic expansion from contraction. Survey based methodologies such as the Consumer Sentiment Index have also weakened, with several readings over the course of the last two quarters that were more representative of the inflation-driven market contraction in 2022. Together these reports indicate a neutral to slightly positive economic trend which, matched with a government shutdown, has given the Federal Reserve room for additional monetary policy easing.

Civilian Unemployment Rate & Year-over-year Wage Growth

Private production and non-supervisory workers, seasonally adjusted, percent



YIELDS & THE FED

The Federal Reserve came through with a widely anticipated rate cut on September 17 and a second 25 bps cut on October 29, dropping Fed Funds from 4.5% to 4.0%. Fed Funds futures indicate a 40% probability of an additional cut at the December 10 meeting.

Since these cuts are a continuation of the easing cycle the Fed initiated in September 2024, it is helpful to review the effects of last year's cuts on 9/18/24, 11/7/24, and 12/18/24, which brought the Federal Funds Rate from 5.5% to 4.5%. Intermediate and long interest rates actually increased over that time-period, with the benchmark 10-year treasury yield moving from 3.7% to 4.5%, implying a bond market at odds with the Federal Reserve, likely based on concerns about deficit spending, increasing debt, and sticky inflation.

When the Fed continued the extended easing cycle with a 25-bps cut in September, the bond market initially reacted the same way it had in late 2024, with rates moving up across most maturities, but rates fell below the pre-cut September 16 level when the Federal government shutdown continued for 10 days with no sign of congressional agreement.

YIELDS & THE FED (CONT.)

Yields Change Since First Fed Cut of Easing Cycle

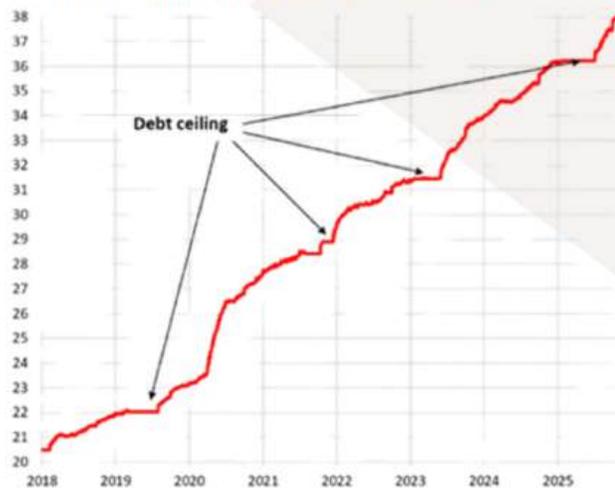
September 18, 2024

Generic Treasury		6 Month	1 Yr	2 YR	3 YR	5 YR	10 YR	30 YR
9/18/2024	1st Cut	4.37%	3.95%	3.62%	3.49%	3.48%	3.71%	4.02%
11/7/2024	2nd Cut			4.20%	4.16%	4.17%	4.33%	4.53%
12/18/2024	3rd Cut	4.30%	4.29%	4.36%	4.36%	4.40%	4.51%	4.68%
2/2/2024		4.29%	4.15%	4.25%	4.28%	4.34%	4.52%	4.76%
Change in Yield From First Cut		-0.08%	0.20%	0.63%	0.79%	0.85%	0.82%	0.74%

Source: Texas Regional Bank Trust and Wealth Management, Bloomberg

If the economy continues to slip, then the Fed's rate cuts may be more likely to influence intermediate and long-term rates downward. If the economy powers through, however, higher rates may serve as a check on the Fed's ability to continue adding liquidity to an extended equity market. Government debt has continued to increase since last fall, despite the noise from The Department of Government Efficiency (2025's best oxymoron has efficiently disappeared) and the impact of tariffs. What ultimately permits an overly indebted country to continue borrowing from the rest of the world is higher rates, and the Federal Reserve may at some point find itself pushing on a string as its influence clashes with the increasing level of US debt and the resulting impact on interest rates, just as it did last fall.

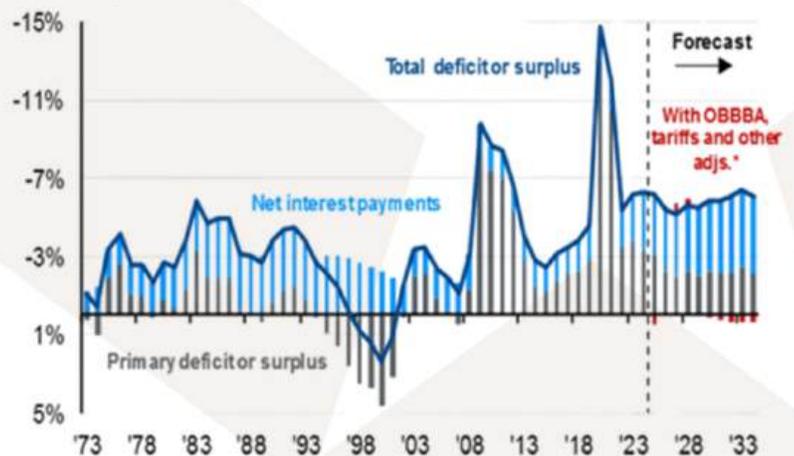
US National Debt: \$38 trillion



Source: US Treasury Dept.

Federal Deficit & Net Interest Payments

% of GDP, 1973 - 2034, CBO Baseline Forecast



Source: JP Morgan

PROFIT MARGINS & EARNINGS

Corporate earnings growth has been a significant positive for public markets throughout 2025, and the sources of growth are constructive, with 2025 year-over-year growth of 10.1% driven primarily by margin expansion and revenue growth, with net share buybacks less of an EPS driver than during other time periods. Current analyst estimates project continued strong growth next year.

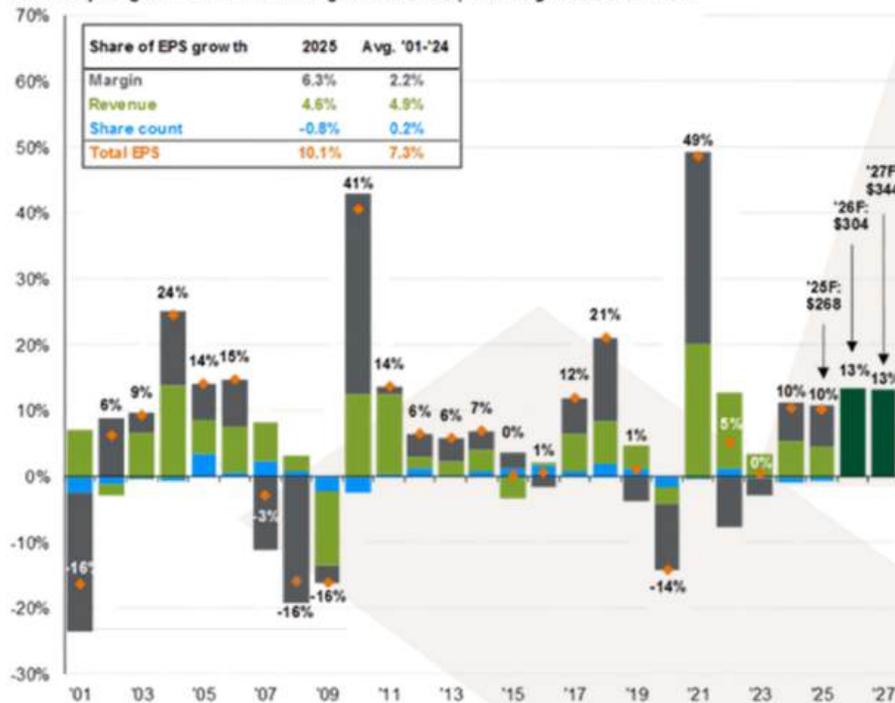
Net profit margins are near multi-decade highs, with 13.6% reported for the S&P 500 at mid-year, well above the 9-11% central tendency since 2002 as well as trough levels of 5% in 2008 and 9% in 2020. These margin highs come despite overall upward adjustments in pricing and services that affect large companies' cost of goods sold.

PROFIT MARGINS & EARNINGS (CONT.)

Expansion has also overcome higher borrowing rates, though many of the large capitalization borrowers in the S&P 500 have termed out their indebtedness at lower interest rate levels through fixed coupon borrowing in the corporate bond market as opposed to smaller private companies that are more exposed to intermediate-term rate changes through adjustable-rate bank loans. As much as \$2.3 trillion in corporate debt will need to be rolled over at higher rates between now and 2027, however, including \$1 trillion in 2026 alone.

S&P 500 EPS Growth

Year-over-year growth broken into changes in revenue, profit margin and share count



Source: JP Morgan Guide to the Markets

S&P 500 Profit Margins

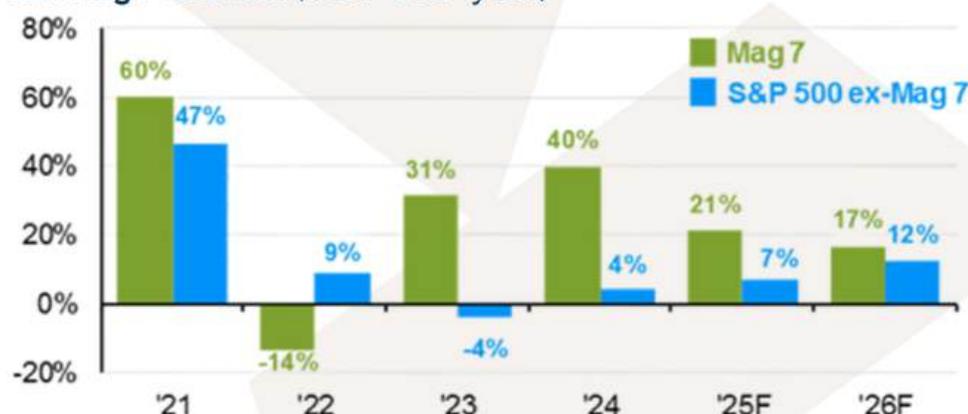
Quarterly earnings/sales



Source: JP Morgan Guide to the Markets

Earnings growth has been most powerful for some of the largest companies, particularly for those technology-heavy companies referred to as the Magnificent 7 (Mag-7), including Apple, Microsoft, Amazon, Alphabet (Google), Meta (Facebook), Nvidia and Tesla. While we are concerned about the level of concentration inherent in equity markets and represented by

Earnings Growth (Year-over-year)



Source: JP Morgan Guide to the Markets

the Mag 7, particularly considering the valuation of the companies that make up that concentration, we also acknowledge that the earnings growth associated with market leadership has been spectacular, with growth 10x the rest of the S&P 500 in 2024 and triple that of the rest of the S&P 500 in 2025. For those that see a bull case in a small group of stocks supporting index performance, earnings growth is the foundation of the story.

CONCENTRATION & VALUATION

The high degree of market concentration in a small number of mega-cap stocks is something we have discussed in every investor letter completed over the past year and a half. We are as tired of talking about it as investors are of hearing about it, but it is an undeniable factor in evaluating today's equity market performance and the health of major equity indices. As the chart below details, the market capitalization of the top 10% of U.S. stocks by size represent over 75% of the total U.S. market, which is historic—a higher ratio than the levels present at the peak of the dot-com bubble, the 'nifty 50' market of the 1970s, and the 1930s peak before the Great Depression.

Market Concentration Over a Century

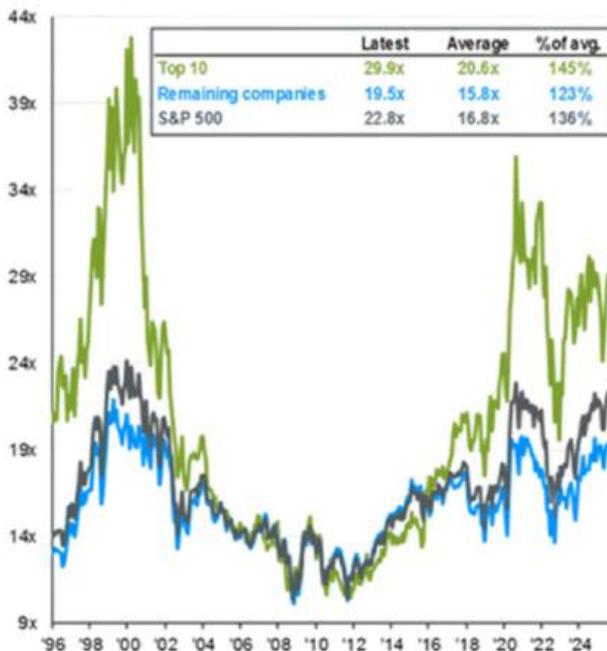
(Top 10% of Stocks by Size v. Entire US Stock Market, as of 8/31/2025)



The largest companies in the S&P 500 are also the most expensive, making the concentration more significant from a valuation perspective—not only are passive investments in the S&P 500 much less diversified, but the concentration adds meaningful valuation risk. The chart below shows the largest 10 stocks in the S&P 500 relative to the remaining 400, with the top 10 stocks representing over 40% of the index and carrying an average price/earnings ratio of 29.9x.

P/E of Top 10 & Remaining Cos. in S&P 500

Next 12 months



Source: JP Morgan Guide to the Markets

Weight of Top 10 Cos. in S&P 500

% of market capitalization, % of last 12 months' earnings



Source: JP Morgan Guide to the Markets

SUMMARY

The current investment landscape is a product of exceptional equity market performance and increasing economic and financial cross currents, with inflation remaining high even as the Fed continues a stop-and-go easing cycle. Employment figures remain strong but with signs of weakening at the margin, GDP and other broad economic gauges are in positive territory, and economic sentiment measures are divided by income levels and political viewpoint. There is little evidence of systemic distress with default rates exceptionally low and credit spreads tight. Fiscal conditions, in terms of tax rates and government spending, have continued to be supportive of economic growth. Interest rates have eased marginally from levels at the end of 2024 but remain higher than has been the case for much of the post-Great-Financial-Crisis era, and there is as much reason to be concerned about long-term rates moving higher from current levels as there is to expect the Federal Reserve to be able to pull them lower.

Equities have climbed 'walls of worry' throughout 2025, initially reacting to the Trump tariff announcements in April with abrupt declines, but bottoming early in the second quarter and moving consistently upwards despite continued noise around tariffs and some of the mid-year challenges that we've discussed in this note. The S&P 500 total return of 14.8% through September follows returns of 26% in 2023 and 25% in 2024, and we are at that point where equity gains seem easy—perhaps too easy.

Our portfolio recommendations are customized on a client-by-client basis, but several opportunities remain consistent for a wide range of clients. In portfolios where it makes sense to decrease risk exposure or increase income potential, our advisors can discuss appropriate ways to allocate away from the most highly valued equity classes where concentration and valuation issues such as those discussed above are most prevalent. This may include adjusting portfolios away from "Magnificent 7" oriented exposure toward equal-weight large-capitalization approaches,

allocating to mid-capitalization US equities where valuations are more attractive and long-term growth rates are more organic, or to strategies that provide more income and less price risk, such as intermediate municipal bonds or certain alternative approaches. Equity valuations and speculative influences

are at very high levels, and this is a good time to sit down with a member of our statewide advisory and financial planning team to check in on financial goals, the plan designed to address those goals, and the risk inherent in your investment approach.



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