

MARKET UPDATE

September 30, 2025

My father was an entomologist (the study of insects) for the Department of Agriculture. During his 40-year career, his job was to find a way, without using insecticides like DDT, to stop corn borers from destroying corn crops.

Near the end of his career, he and a fellow researcher from Japan found a way to prevent a pheromone signal from the female reaching the male so they wouldn't mate. Near the end of their careers, they presented a paper to farmers to use this method.

It worked for a few years, but the insects evolved and rendered the effort useless. Like insects, so it is with investing – evolve or die.

The current chaos in stock markets

The chaos of the past year is evidence of how certain investment sectors have evolved while others have faded. Think of the decline of buggy whip sales when the automobile was first introduced in Germany in 1886 by Karl Benz (of the Mercedes-Benz brand).

For many decades, investors could place their money in three sectors (healthcare, software and

food companies) and enjoy the profitable share price compound growth that came from consistent, rising demand for their products or services.

An abrupt change to policy in the form of U.S. government spending cuts and tariffs, along with advances in artificial intelligence, appear to have threatened those business models.

To explain, let's consider the role of change caused by the U.S. Federal Government.

U.S. Government Policy Changes – The Republican Party's playbook

One of the cornerstones of the administration's economic policy is U.S. Treasury Secretary Scott Bessent's 3-3-3 plan: 3% GDP average growth, 3% annual budget deficits (as a percentage of GDP) and increasing the U.S.'s domestic oil production by 3 million barrels/day.

The first two components of Bessent's plan are a challenging combination. Intuitively, increased government spending leads to increased GDP growth. The current budget deficit is around 6.5% of

GDP, so reducing that to 3% will require legitimate cuts (to healthcare and education), not marginal. Since 2020, the ratio has consistently exceeded 5%. Yet, if the denominator in that ratio (GDP) increases significantly, that may be possible.

Achieving 3% GDP growth will require an uptick in economic activity, which is why the administration wants to lower interest rates to about 1% and reduce the value of the U.S. dollar. The recent federal government shutdown has offered the government the opportunity to shut down whole agencies to help reduce the spending side of the equation.

The third component of Bessent's plan is to increase domestic oil production. The U.S. is currently the world's leading oil producer, producing around 13 million barrels a day. Increasing this total by approximately 25% would be an uptick in economic activity and a boost to GDP.

Other changes include healthcare and education spending cuts, an increase in funding to the Pentagon and using tariffs to cut deficits – let the rest of the world pay for the privilege of trading with the United States.

If it works, the U.S. can maintain its dominance as a world economic leader. If it doesn't, the rest of the world could bypass U.S. isolationism and leave it facing the end of its Republic.

Threats to the 3-3-3 strategy

Will the strategy work? It's too early to assess but there are certainly some risks, both economic and political, that could hurt the administration's goals:

1. A loss of innovation

China is innovating equally as fast as the United States. If the U.S. loses this standing, global investment monies could flow elsewhere to Europe, China or the Emerging Markets. Couple this with a revamped policy of revoking H1-B Visas and brainpower could stop moving to the

United States to help with its innovation needs.

2. A drop in the U.S. dollar could cause inflation to U.S. consumers

Whenever a currency devalues, the cost of imported goods rises and causes inflation. U.S. consumers are currently suffering the impacts of higher prices for food, gasoline and other essentials.

Small U.S. businesses are crippled by the tariff wars as many goods or finished parts are imported from China, India or Vietnam, countries that face tariffs that are 40% or higher.

These companies account for approximately 44% of U.S. gross domestic product (GDP). They also generate nearly half of the private-sector jobs and are responsible for a significant portion of U.S. exports.

Their current conundrum is whether to pass on the higher costs to their customers (causing inflation), or eat the costs, lay off staff and suffer lower profits.

3. Turning its back on its allies could have devastating effects for the United States if global trade circumvents the U.S.

There are about 400 million people in the U.S. and 7.8 billion people elsewhere in the world. If countries get tired of political and economic bullying, they may find ways to trade elsewhere.

Next, let's discuss the sea change in investment trends.

Changing investment trends

Like the introduction of the automobile, the growth of artificial intelligence may one day make some sectors obsolete.

The first step to some sector obsolescence has been the introduction of hyperscalers, large-scale cloud computing services that operate massive

data centers with vast computing, storage, and networking resources. They include Amazon Web Services (AWS), Microsoft Azure and Google Cloud Platform. It's why Liberty owns Microsoft Corp. as a core holding in client portfolios.

Today's trends favour:

- **Artificial intelligence** – Stocks that are leading the way in the future of hyper scaling, learning, robotics, medicine, etc.
- **Computer chips** – Stocks that design or make current AI computer chips, with an eye to creating the next generation of chips for quantum computing
- **Infrastructure** – Stocks that provide energy sources / electrification to power the data centers, or help deal with climate change
- **Serial Acquirers** – Stocks that exemplify operational discipline and long term value creation through strategic capital deployment
- **Financials** – Stocks that provide the capital for the next leg of economic growth

These trends are borne out by sector stock performances this year. At right are the sub-index results of the S&P 500 Index (all in U.S. Dollars) for the year-to-date to September 30th.

The winners are mostly in the technology sector with Artificial Intelligence and chip manufacturing leading the way, the momentum stocks of today.

The laggards, meantime, are Consumer Staples (up 2% YTD) and Healthcare (up 1%). The former industries have been hurt by changes in diet (weight loss drugs have hurt companies that manufacture ultra-high processed foods) while changes in U.S. spending cuts have hurt healthcare companies.

The other trends are investments in Emerging Markets and in non-North American currencies (away from the U.S. and Canadian dollars). Below are stock index returns for 2025 from January 1st to September 30th (simple price returns in their own native currency):

Equity Price Returns in Native Currency (First, Second, Third Quarter and Year-to-Date to September 30, 2025)				
STOCK INDEX	Q1	Q2	Q3	YTD
MSCI Emerging Market Index (MXEF)	+2.31%	+11.02%	+11.11%	+24.44%
TSX Composite Index (Canada)	+0.76%	+7.78%	+12.87%	+21.41%
Nasdaq Composite (Technology)	-10.42%	+17.75%	+10.01%	+17.34%
MSCI Global Index (World)	-2.14%	+10.96%	+6.83%	+15.65%
S&P 500 Index (United States)	-4.59%	+10.57%	+7.73%	+13.71%
Nikkei Index (Japan)	-10.72%	+13.67%	+9.68%	+12.63%
EuroStoxx 600 Index (Europe)	+5.18%	+1.40%	+3.38%	+9.96%
Russell 2000 Index (US Small-Cap)	-9.78%	+8.11%	+10.92%	+9.25%

Data Courtesy of Bloomberg L.P.

SUB-INDEX		YTD PRICE GAIN	NAMES INCLUDE:
S5TELS	Communications	24%	Google, Meta, Netflix
S5INFT	Information Technology	22%	Microsoft, Nvidia, Apple, Chip Manufacturers
S5INDU	Industrials	17%	Railroads, Boeing, Caterpillar, Deere
S5UTIL	Utilities	15%	Gas, Water & Electric Utilities
S5FINL	Financials	11%	Banks, Insurance Companies, Visa
S5MATR	Materials	8%	Dow, DuPont, Steel & Metals companies
S5COND	Consumer Discretionary	5%	Amazon, Home Depot, Starbucks, McDonald's
S5ENRS	Energy	4%	Oil Companies and Refiners
S5RLST	Real Estate	3%	Real Estate Investment Trusts (REITs)
S5CONS	Consumer Staples	2%	Coca-Cola, Costco, Hershey, Target Stores
S5HLTH	Healthcare	1%	Pharmaceuticals, Life Sciences, Medical Devices
S&P 500 Index Average		14%	

Data Courtesy of Bloomberg L.P.

In the past 10 years, the S&P 500 Index earned an annual return of 11% as U.S. stocks rode the wave of new trends in technology, corporate tax cuts and a rising U.S. currency. This is compared to the MSCI Emerging Market Index (MXEF) where its return over the same time period was a paltry 3%.

The S&P/TSX Composite, the Canadian stock market index, returned 7% during that period. Why the change in appeal from the past decade to the big winners this year?

For Canada, the performance of gold and financials has led to the 21% return noted above. But the Canadian stock index is heavily weighted to those sectors and doesn't provide enough diversification, especially with the drop in the Canadian dollar this year, hence the new interest investing in global markets. The reasons supporting international stocks are five-fold:

- The S&P 500 trades at 25 times earnings versus the MXEF's 15 times. This attracts value investor attention. Money flows have moved out of the U.S. and into international markets.
- International markets have had a decade of underperformance. It's now an underweight percentage in many portfolios of large institutions and they are currently in catch-up mode.
- A declining U.S. dollar has made total returns in other currencies look weak (see Currency discussion below). Investors are now hedging those bets with multiple currency portfolios.
- Dividend yields are higher with MXEF (2.37%), thus providing more income than the S&P 500 Index ETF (1.17%).
- Government spending has risen among emerging market countries to counter U.S. tariffs. This could lead to better economic growth internationally.

Liberty has always held global portfolios for clients with multiple currencies in them to provide for better diversification and risk management. We don't have to play catch-up because we've always been invested globally.

Bonds

Foreign bonds are the winners this year as their yields are better than Canada's. Global corporate bond yields for mid-term maturities (5-7 years) in specific countries are as follows:

- Brazil – 6% to 8%
- Mexico – 5% to 7%
- Britain – 5% to 6%
- United States – 4% to 5%
- Europe – 3% to 4%
- Australia & New Zealand – 3% to 5%
- Canada – 2.5% to 3.0%

With a 5% demise in the Canadian dollar this year, total international bond returns have been in the 7% range (currency adjusted). That's why we've been focused on buying foreign bonds for the past year.

Currencies

For the first time since the 2008 financial crisis, both the Canadian dollar, down 5.38%, and the U.S. dollar, down 9.46%, have declined in tandem.

By moving money out of the U.S. and into, say, European stocks, the U.S. dollar would fall on the sale of U.S. dollars and the Euro would rise on the purchase of Euros. That's why the Euro is up 13.84% versus the U.S. dollar this year.

It's important to think of the short-term impact on currency moves on investor returns. Consider an investment in Costco Wholesale Corp. (COST US) by three different investors: One American, one Canadian and one European (see chart below):

Costco 2025 Performance for three different investors

INVESTOR	CURRENCY	SIMPLE PRICE RETURN IN THEIR NATIVE CURRENCY YTD TO SEPTEMBER 30, 2025
American	U.S. Dollar	+1.02%
Canadian	Canadian Dollar	-2.26%
European	Euro	-11.07%

Data Courtesy of Bloomberg L.P.

When converted to their own native currency, the investment returns are quite different. While the U.S. investor was up 1% to September 30th 2025, the Canadian investor was down 2% in Canadian dollars and the European investor was down 11% in Euros.

This is why pension funds, hedge funds and large investment institutions are hedging their U.S. dollar exposure. This is an added cost for those large institutions because banks charge a monthly fee to hedge these positions with currency forwards or options.

Since 2000, however, the average annual change between the Canadian dollar and the U.S. dollar has been only 0.2%, while the Euro versus the Canadian dollar has been 0.7%. Over a 10–20-year time horizon, therefore, currency risk is benign. At Liberty, we find these hedging strategies costly and imprudent for investors.

If you wish to own foreign equity Exchange-Traded Funds (ETFs), don't buy the hedged versions.

Pop Goes the Bubble

As we end our discussion on this year's stock market index performances, we can't ignore the rumblings of commentators who point out the concerns of what may be considered an overheated market. The table at right identifies some of the worst and longest market corrections in the past 100 years.

An October 14th *Globe & Mail* article by Brenda Bouw asked market strategists their opinions of where we are in the market. Here are two of them, the most bullish and the most bearish.

"Brian Belski, *BMO Capital Markets*' chief investment strategist, believes the U.S. and Canada are in a 'big, giant bull market' and that investors have been too cautious."

"Mr. Belski believes North American markets are in the third inning of the current cyclical bull market – which he says began in October 2022 in the U.S. – and in the fifth or sixth inning of a 25-year secular bull market he says started in 2009 in the U.S."

"David Rosenberg, founder of independent research firm *Rosenberg Research and Associates Inc.*, is more bearish on equity markets, believing the bull market is in "extra innings."

"Mr. Rosenberg believes the market is in a bubble that began in June 2024. And, pointing to historical data showing bubbles last an average of 18 months, "I would suggest the clock is ticking."

Given that opinions are at such extremes, what's an investor to do?

The most prudent solution is to diversify globally by industry, country, currency, and size of company. Diversification limits the upside (it's doubtful you'll make 30% in any one year), but it also protects investors from the downside (you shouldn't lose 30% of your money, either).

HISTORICAL STOCK MARKET CRASHES	WHEN CRASH BEGAN	INDEX	DURATION OF CRASH	PRICE LOSS FROM TOP OF THE MARKET
Crash of 1929	September 30, 1929	S&P 500	33 months	85.3%
Nifty-Fifty	January 11, 1973	S&P 500	21 months	48.2%
Nasdaq Crash	March 10, 2000	Nasdaq	31 months	76.9%
Dot-Com Crash	March 24, 2000	S&P 500	31 months	47.3%
Financial Crisis	October 11, 2007	S&P 500	17 months	56.0%

Data Courtesy of Bloomberg L.P.

At Liberty, our technology exposure is in the 10% to 20% range of total portfolios. We wish to participate in the sector but we have no plans to ruin investor futures or retirements by going whole hog.

Remember the old investment axiom: Bulls make money. Bears make money. Pigs get slaughtered.

If you have any questions, let us know.

David Driscoll CIM
President & CEO

Brett Girard CPA, CA, CFA
Portfolio Manager & CFO

Annie Bertrand CIM
Portfolio Manager

Rory Burke CFA
Associate Portfolio Manager

The commentary in this newsletter should be considered general commentary only. The above language is intended for informational purposes only and is not intended to constitute accounting, legal, tax, or investment advice. You should consult directly with a Liberty professional before acting on any information in this newsletter.