First Citizens Wealth™

Making Sense

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Solid, not seamless

CONTACT

Blake Taylor | VP, Market and Economic Research Analyst
blake.taylor@firstcitizens.com
919-716-7964

Phillip Neuhart | SVP, Senior Director of Market and Economic Research
phillip.neuhart@firstcitizens.com
919-716-2403

Brent Ciliano, CFA | SVP, Chief Investment Officer
brent.ciliano@firstcitizens.com
919-716-2650

1. Less perfect

US equity markets have been slightly choppier but the S&P 500 index still hasn't sold off by more than 3% from all-time highs since June.[i] We remain cautiously optimistic for several reasons. 1) S&P 500 earnings grew 13% year-over-year in the third quarter, and over 80% of companies beat analyst expectations.[ii] 2) We think the tick up in volatility and the modest move lower in the price following decent earnings is more understandable given today's stretched valuations. 3) There appears to be decent momentum in the economy with forecasters expecting real GDP growth of around 3-4% last quarter. 4) Financial conditions indices – composite measures of equity and bond prices, the dollar, and credit spreads – appear easy, and this relatively accommodative stance is likely supporting GDP growth. 5) Choppier markets don't necessarily bother us: we think the last 5-month stretch of nearly uninterrupted gains – not volatility – is the exception.

2. High expectations

All that said, we acknowledge the elevated valuations embedded in today's equity markets – particularly in mega cap tech – and we also see a lot of good news already accounted for in today's prices. In these conditions, markets might react more swiftly – and strongly – to bad news compared to recent quarters, especially as many investors may already be looking to take risk off the table anyway with markets up ~15% year-to-date despite the 19% selloff earlier in the year.

3. Still spending

Earlier this year, we were attuned to a slowdown in inflation-adjusted spending, particularly for households in the lower part of the income distribution who we think experienced little to no growth in real spending after the post-pandemic income and savings boom dissipated. The latest data suggest Americans are likely spending at a faster rate compared to several months ago, even after adjusting for elevated rates of inflation. That said, pockets of softness are showing up among certain cohorts. We think wealth effects – households spending a modest fraction of their new gains in stock and home-equity assets – are likely an important factor in supporting household spending. This connection between asset prices and the real economy concerns us a bit because any decline in risk assets could leave consumer spending exposed. But we don't think this tells the whole story. While we acknowledge the recent increase in reported layoffs, a near-record share of Americans in their core working years are employed, a remarkable feat considering the economic history of the last few decades. We think this pattern of solid employment, income, and spending can occur for longer, and we hope it will, even if conditions aren't as favorable for many households as they were in recent years.

[i] Daily close data
[ii] Source: FactSet

4. No story to tell

In his last press conference, Federal Reserve Chair Jerome Powell said "there's just no story" in the recent data that support the narrative of a rapidly deteriorating labor market. Granted, this was before an announcement last week from a private-sector data aggregator that job cuts in October surged. Recent data – or a lack thereof – complicate the ability for investors, analysts, and policymakers to present a persuasive narrative for the economy and outlook. A consequence of the longest government shutdown in history is a halt in timely, official economic statistics: the latest official employment report on goes only through August, and the postponement of this week's CPI inflation report complicates the Fed's ability to evaluate the risks to inflation as they consider cutting interest rates further.

5. Different rates, different traits

Longer-term interest rates depend on a multitude of factors, only one of which is whether the Federal Reserve is cutting its overnight policy rate. Since the Fed lowered interest rates in September, the 10-year Treasury yield is little changed at around 4%. Mortgage rates have moved a bit lower, now approaching three-year lows. Corporate bond spreads – the risk premium investors demand to hold non-government debt – have leveled off after a monthslong steady decline. Investors have tempered their expectations for a rate cut at the December Federal Reserve meeting, but markets are still priced for a total of three more quarter-point cuts between now and the end of next year.