KENSINGTON MONTHLY COMMENTARY

September 2025

Stock Market

Equities extended the powerful rally that began in mid-April. In September, the S&P 500 rose 3.53%, the Nasdaq 100 gained 5.40%, and the small-cap Russell 2000 advanced 2.96%. International markets generally moved higher as well, with emerging markets leading; the MSCI Emerging Markets Index was up 7.05% for the month.

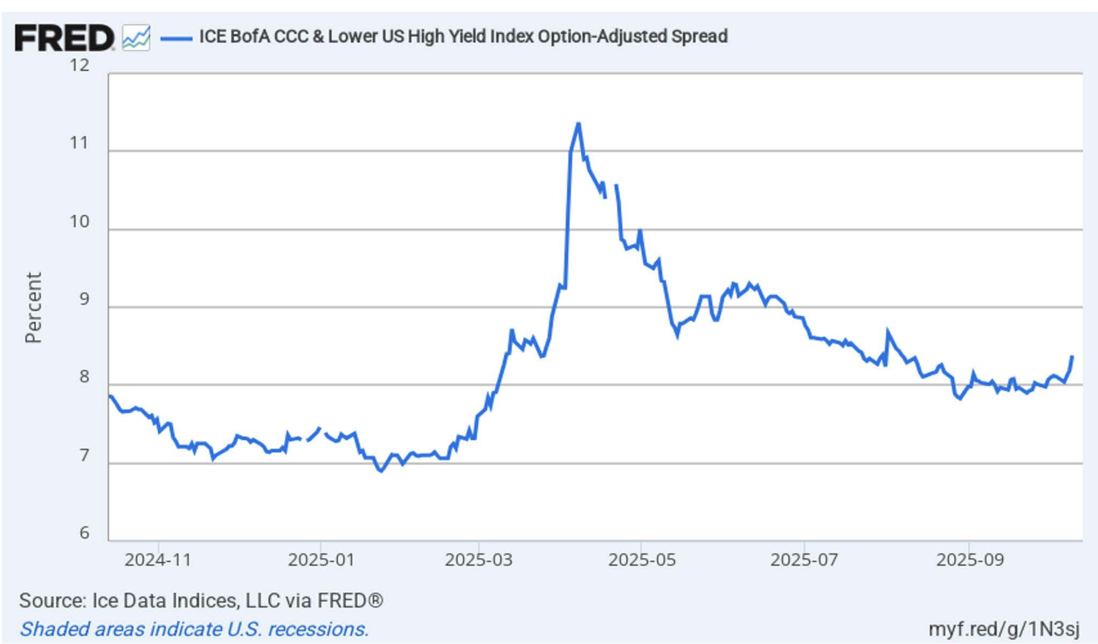
From the mid-April low through September, the S&P 500 rose roughly 33%, a remarkably swift advance for such a short window. The run included a five-month winning streak, one of about 30 such streaks since 1950. Powerful multi-month rebounds of similar character have followed prior shocks, like the 2009 post-GFC bottom and the 2020 COVID rebound. By contrast, the late-1920s upswing was a longer build culminating in the September 1929 peak rather than a concentrated five-month sprint.

Episodes like this are difficult to capture, since they often occur after extended drawdowns or sharp corrections when pessimism runs high and bearish narratives sound persuasive. At the other extreme, late-cycle surges can tempt investors to chase, as fear of missing out rises and skeptics are repeatedly proven early. In both cases, sticking to a rules-based process and an appropriate time horizon may be important.

Fixed Income

Bonds posted another month of gains. In September, the S&P US 10-year Treasury Index returned 0.94%, the Bloomberg US Corporate Investment Grade Index rose 1.50%, the Bloomberg US Mortgage-Backed Securities Index gained 1.22%, and the Bloomberg US High Yield Index advanced 0.82%. The S&P US 30-year Treasury Index, a recent laggard, rallied 3.50%.

Two drivers stood out. First, the Federal Reserve cut rates at mid-month, which shifted the yield curve lower. Second, labor-market signals softened at the margin. Slower hiring and pressure on lower to middle income consumers have been visible for some time, including rising auto loan delinquencies among lower-income borrowers. Thus far, credit markets have largely looked past these strains as profits remain resilient, equity gains support spending, and AI-related investment continues to provide a tailwind to activity.



There are early signs to watch. Riskier high yield cohorts have seen spreads grind higher, even as broad high yield benchmarks remain contained. Business development companies (BDC), which tend to feel tightening credit conditions early, have underperformed since July. Bank of America recently noted realized losses across BDCs exceeding $1 billion in the second quarter, the highest dollar value since the pandemic. They are also carrying an additional $1.3 billion in unrealized losses, mostly from loans originated in the low-rate environment of 2021.

Importantly, primary markets remain open. US investment-grade borrowers raised roughly $207 billion in September, one of the largest non-COVID months on record, while junk-rated issuers placed a heavy calendar of leveraged loans last quarter. Much of this activity reflects refinancing rather than net new borrowing. After accounting for maturities and buybacks, 2025 net issuance has been modest or negative at times, a dynamic that has helped keep index-level spreads relatively tight.

Federal Reserve and Policy

The Fed lowered its policy rate in September and markets expect another 25 basis point cut at the October meeting. Policymakers are navigating a complex mix of slowing labor-force growth, shifting immigration trends, corporate uncertainty around AI's long-term impact on hiring, and a thinner flow of timely economic data during the government shutdown. Tariff policy adds an extra variable to the inflation and growth outlook.

Investors appear to have increasingly embraced what many refer to as the "debasement" trade, favoring gold, silver, and digital assets as potential hedges against currency and policy risk. The move seems it has been building for some time and sentiment around these hedges has become enthusiastic. While the Fed typically avoids commenting on market prices, the rotation into "hard" or non-dollar assets reflects broader doubts about inflation trajectories, fiscal sustainability, real yields, and the dollar's long-run purchasing power.

Large and sustained flows into these hedges could complicate the policy backdrop by dampening demand for Treasuries, putting upward pressure on long-term yields, and introducing additional dollar volatility. Fiscal consolidation remains outside the Fed's mandate, requiring the executive and legislative branches. The intersection of monetary easing with fiscal choices will be an emerging key macro variable into year end.

Bottom Line

- Equity momentum remains strong, but leadership and risk appetite should be monitored as the rally matures.
- Fixed income benefited from Fed cuts and softer labor signals, yet pockets of credit stress bear watching.
- Primary markets are active, but refinancing dominates, which has helped keep spreads contained so far.
- The Fed is easing in a complex environment. The interaction of rate cuts, fiscal policy, and investor hedging behavior is central to the path of yields and risk assets from here.

Authors

Kensington Asset Management PM Team

Disclosures on next page