



BERNSTEIN

## The Market Climbs a Wall of Worry

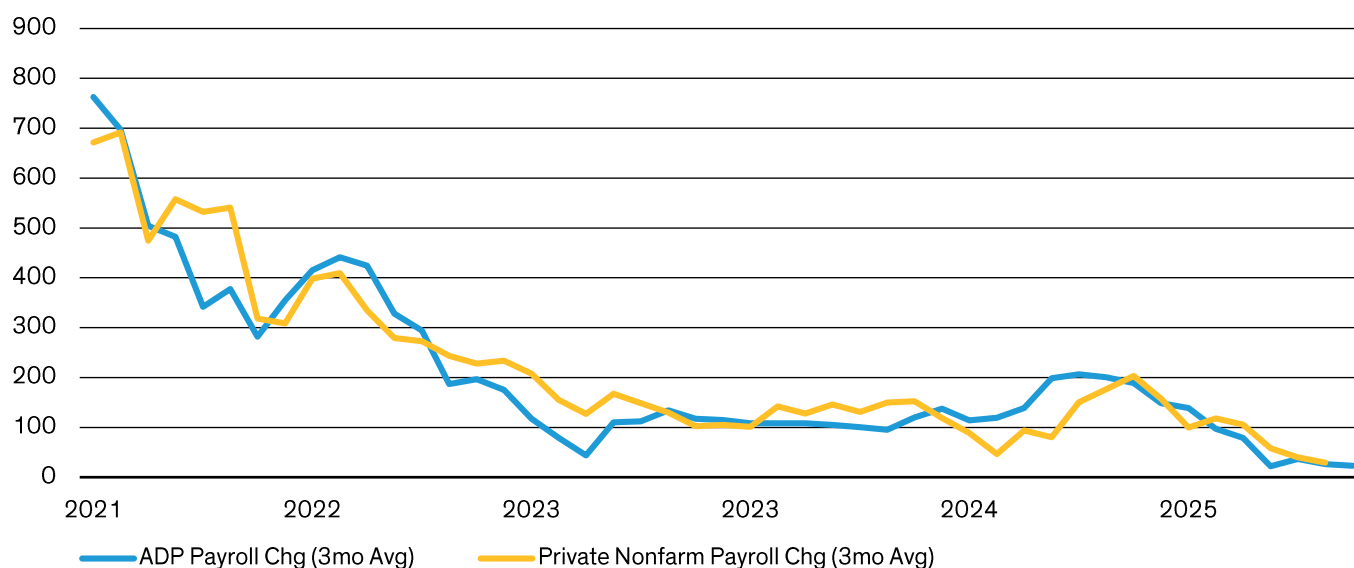
As I put the final touches on this letter, the US government shutdown is about to cross the one-week mark. Meanwhile stocks, gold, bitcoin—and even bonds—all sit at or near all-time highs. And many of you just experienced a very strong quarter across your Bernstein portfolios. Are we underestimating the resilience of the market, or is there a hidden risk we’re not seeing?

As far as the shutdown goes, we don’t fear the path through it or its ultimate conclusion. After all, the economic and market ramifications have historically been quite limited (sadly, we have plenty of precedents to compare with). But one aspect of the current stalemate does concern us. As the economy continues to wrestle with conflicting signals and trends, both policymakers and market participants would benefit from timely, accurate data to guide their decision-making. Yet with the government temporarily closed, many of the most important inputs that the Federal Reserve and investors like us rely on remain unavailable.

Thankfully, there are other data points. For instance, nontraditional sources capture the impact of higher tariffs on prices. To take the pulse of the consumer, we can sift through summaries of income and spending trends produced by major banks. And when it comes to the labor market, we can assess figures from ADP and other private providers, rather than nonfarm payrolls (*Display 1*). Coupled with our access to Bernstein Research, which ranks among the finest research on Wall Street, we have pieced together a fairly solid picture. For the time being, our working knowledge suggests that prices are rising in response to tariffs, consumer spending is bifurcated across income and age groups, and the labor market is soft but not rolling over.

### DISPLAY 1: EVEN WITHOUT GOVERNMENT DATA, WE CAN MONITOR THE LABOR MARKET

Thousands of Jobs



As of October 7, 2025. **Past performance does not guarantee future results.**

Source: ADP, BLS, Macrobond, and Bernstein analysis

## The Catch-Up Quarter

After a tumultuous start to the year, stocks and bonds kicked into gear during the third quarter.

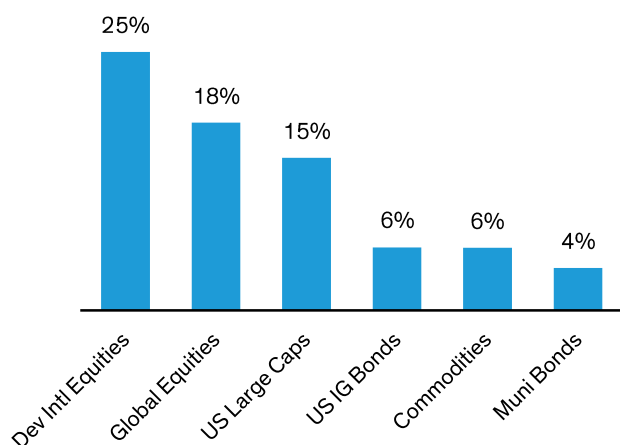
In equity markets, US stocks continued closing the gap relative to international stocks, surging 8% versus 4% for their overseas counterparts. But international stocks remain well ahead for the year, up 25% compared to just 15% for the US broad market (*Display 2*). It's a powerful reminder of the value of international diversification. We live in a global economy with a global investor base—at times, the US will outperform and at times it will be the laggard.

After a tough start to the year, taxable investment-grade bonds held their own and are now up 6% year-to-date. Municipal bonds have faced stiffer headwinds. They underperformed as many municipalities issued new bonds to ensure they'd be grandfathered amid talk of changes to their tax treatment, which led to oversupply. With the OBBBA tax legislation now signed—and the favorable tax treatment of municipal interest payments intact—the balance between supply and demand is normalizing and performance has stabilized.

Meanwhile, commodities have held up well in the face of geopolitical stresses, with a diversified basket returning 6% so far in 2025. Gold remains a standout. After a 27% return in 2024, it's up another 47% year-to-date. So, while it hasn't had a great 40 years, it has had a great 21 months.

### DISPLAY 2: GLOBAL ASSET RETURNS ARE NOW STRONG ACROSS THE BOARD FOR THE YEAR

Percent



As of September 30, 2025. **Past performance does not guarantee future results.**

Source: Bloomberg and Bernstein analysis

## The Labor Market, the Stock Market, and the Balance of Risks

From an economic standpoint, the softening labor market is the major issue in the crosshairs. The slowdown has arisen from two sources:

- The labor market was weaker coming into the year than contemporaneous statistics suggested.
- It has further softened through the year, due to a combination of cyclical factors and macroeconomic uncertainty caused by how tariffs were implemented.

The concern now? That the weakening labor market undercuts consumer spending, weighing down economic activity overall. The Fed's decision to reduce interest rates by a quarter point in September was driven entirely by the risks posed to the economy by the labor market's struggles.

Meanwhile, the stock market has chosen to look through the cooling labor market, instead taking comfort in the Fed's response—cutting rates. As earnings continue to grind higher, management guidance stabilizes and improves, and the Fed embarks on a cutting trajectory, the market remains optimistic that the expansion and bull market both have room to run.

For our part, we take solace in the fact that despite widespread uncertainty and rising risks in Q2, earnings remained strong, with 12% year-over-year growth—beating consensus by 7%. What's more, guidance from Q2 earnings calls held fairly steady and even grew more optimistic as the season went on (and April's tariff drama faded in the rearview window). These facts matter more than DC politics!

Valuations remain high and the labor market is the weakest it has been in roughly a decade, outside the pandemic era. The risks are real. But unless corporate managers initiate widespread layoffs, we're inclined to think the market has it more right than wrong.

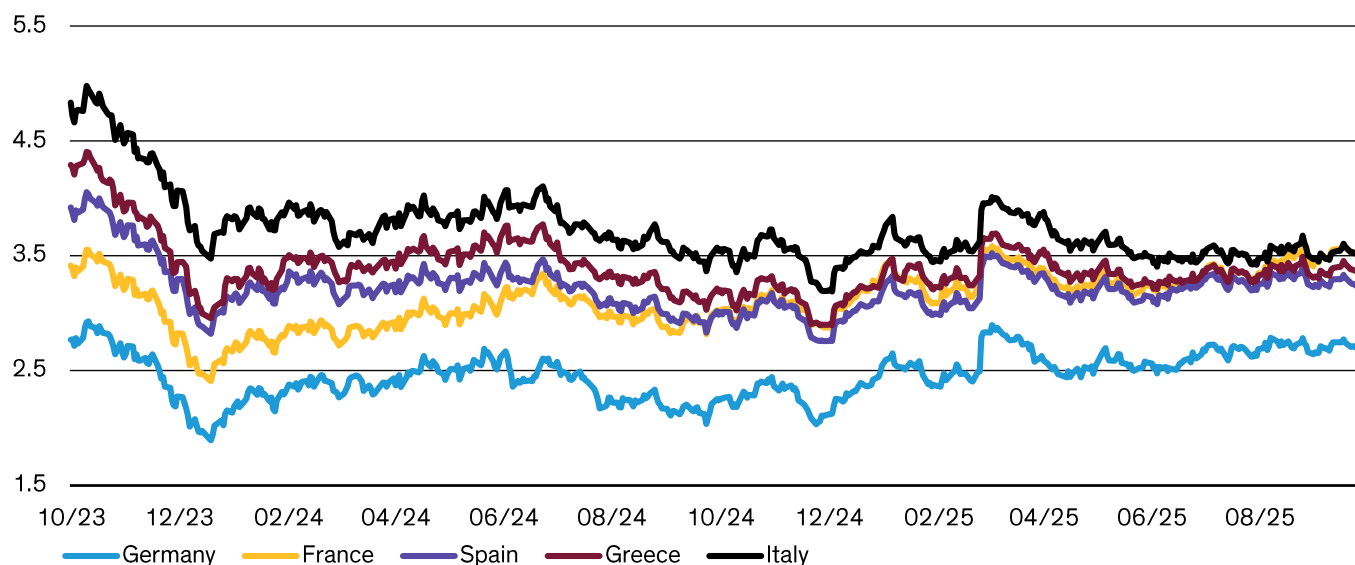
## Debt Is More than a US Issue

The shutdown has drawn attention back to the US national debt, [a topic we've written about](#) at length. Yet, other countries are grappling with the same issue. During the third quarter, those travails finally bubbled over in Europe in a meaningful way. The market's response suggests that if bond vigilantes revisit our shores, the shock could be worth somewhere between 50–100bps of yield.

In France, budget negotiations during the summer set off a market reaction and even toppled the incumbent French government. The scale of the market's reaction is informative (*Display 3, page 3*). A year ago, France and Spain were considered equally risky, with equivalent yields. Yet as France's budget efforts have played out, its yields have now surpassed those of Greece and matched Italy's. This means they are about half a percentage point higher than where the market thought they should be just two years ago.

## DISPLAY 3: DEBT SUSTAINABILITY CONCERNS ARE NOT JUST A US ISSUE

10-Year Sovereign Bond Yields of Select Eurozone Countries (Percent)



As of October 7, 2025. **Past performance does not guarantee future results.**

Source: ADP, BLS, Macrobond, and Bernstein analysis

This adds to our set of precedents, including the market's response to the UK budget negotiations in 2022, which also took down their government. There, the impact appears to be worth around a percentage point of yield. These two examples, along with other historical ones, give us some confidence in that 50–100bps estimate from a reset in the market's belief about debt sustainability.

### Fed Independence in the Spotlight

Meanwhile, in the US, fiscal policy took a backseat as attention shifted to monetary policy this quarter. While the Fed's decision to start cutting rates again was significant, the bigger story was central bank independence. President Trump appointed the White House's chief economic advisor to the Fed and tried to remove another voting member of the Federal Open Markets Committee, raising concerns about the Fed's autonomy.

Central bank independence is one of the most sacrosanct principles in modern economic policy. History suggests that the loss of central bank independence is a harbinger of future inflationary concerns. This is not just a Bernstein house view—or even my own personal viewpoint. The markets reacted quite negatively to the specter of a replacement and quite favorably when the Supreme Court ruled against President Trump. The largest investors in the world were calling for order and trading accordingly.

There are numerous examples of other countries going down this path. I'll spare you the history lesson and just tell you: they all ended badly.

Consider just one from our own past. In the 1970s, undue pressure from President Nixon on then-Chair Arthur Burns is widely credited as a key cause of high inflation. As with the other episodes seen

around the world, leaning on the central bank to loosen monetary policy in the pursuit of short-term economic growth kicked off an unbridled wave of inflation. With the central bank's credibility tarnished, putting the genie back in the bottle became both difficult and painful.

That's why economists and market participants take central bank independence so seriously. It's not binary. Degrees of pressure and independence always exist. But somewhere in there sits a bright red line that no one in the US should wish to cross.

### Bubble, Bubble, Toil, and Trouble?

As the quarter has unfolded, another set of worries has emerged. The AI theme has come back to the fore, dominating headlines and markets. As a result, we've fielded a notable uptick in questions regarding the pace of AI advancement, potential constraints on its growth, and whether we're seeing an AI bubble.

We'll have more to say on all those fronts in the coming months. For the time being, let's focus on that last question. If we were in an AI bubble, how would we know? Here are a few key metrics:

- Sharp stock price increases
- Lofty valuations
- Unachievable estimates

We've certainly seen the first of those three. AI has fueled some astonishing stock price moves, adding trillions of dollars of market capitalization. Since the November 2022 launch of ChatGPT, chipmaking leader Nvidia has risen over 1,000%.

Valuations are less clear. Many of the largest companies with legacy businesses trade at forward P/E multiples in the 20–40× range. That’s a far cry from the 50–100× or higher multiples associated with the dot-com bubble. On the other hand, other less established players are garnering valuations in the hundreds of billions of dollars despite less than \$5 billion in revenues.

As for realistic estimates and how much hype is built into expectations? That’s harder to assess. We question the returns on investment that companies can generate from their AI spending. Likewise, we wonder about constraints on chip sales and datacenter buildouts in terms of energy needs, water consumption, and political obstacles.

Yet with that said, we have virtually no doubt that AI will be one of the most important technological achievements of our lifetimes. It will definitively drive significant economic activity and corporate earnings power for decades to come.

## The Power of Diversification

We’re longstanding fans of diversification. But in times of elevated uncertainty, it becomes even more essential. Coming into 2025 and throughout this year, diversification has been the single most important point we’ve emphasized in our clients’ positioning.

Investors can benefit from diversification in two major ways. First, diversification can help your portfolio navigate a range of economic scenarios. Second, and less obviously, it gives you the confidence to keep your capital in the markets instead of sitting on the sidelines. That lets you enjoy steady compounding over time, regardless of the concerns of the day.

Whether you call it “climbing a wall of worry” or “melting up,” markets often sit near all-time highs as they slowly but surely set new records. Our goal is for your portfolio value to do the same, while seeking to provide downside mitigation against inevitable downturns and setbacks.



As always, thank you for trusting us as the stewards of your capital. We take that trust seriously and aim to be responsible fiduciaries for you each and every day.

Best regards,

A handwritten signature in dark ink, appearing to read 'Alex Chaloff'.

**Alex Chaloff**

Chief Investment Officer

Alex Chaloff is the Chief Investment Officer and Head of Investment and Wealth Strategies at Bernstein. In this role, he leads a national team of strategists across investments and wealth planning—including asset allocation advice, investment platform oversight, model portfolio construction, new product development, manager research, tax planning and solutions, and estate planning research—while remaining continuously focused on moving our clients forward with strong after-tax risk-adjusted returns. Alex has spent his Bernstein career refining our investment platform, listening to clients, and conducting deep research into investment and wealth planning topics that are critical to achieving clients’ goals.

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