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EQUITY INSIGHT

STEADYING MACRO, SCOPE FOR BROADENING

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- **Backdrop:** Growth is holding up while inflation keeps easing, and the Fed's discussion has shifted from more hikes to a measured path toward cuts.
- **Markets:** U.S. stocks are up YTD with quality/AI-linked names still leading; breadth is improving as the yield curve becomes less inverted and small caps stabilize.
- **Earnings:** corporate earnings are broadly steady, and earnings revisions are no longer deteriorating, a constructive environment, so long as rates drift lower and demand doesn't weaken.
- **Playbook:** Stay invested with a Quality-first core; add measured small-cap and select Industrials exposure while the curve steepens. Keep positions sized modestly.
- **What to watch:** Next CPI and jobs prints, the slope between the 10y Treasury and the 3m Treasury Bill, and High Yield Bond spreads. If inflation re-accelerates or credit widens, trim cyclicals; if economic growth pick up and the curve keeps steepening, add a notch to cyclicals.

Summary

This month still looks friendly for equities. Growth is holding up, inflation is easing from last year's highs, and the policy conversation is shifting toward gradual rate cuts rather than more hikes. The yield curve is less inverted than it was earlier in the year and the manufacturing PMI is hovering near the 50 line - hardly a boom, but no obvious deterioration either. Earnings expectations have stopped slipping, and breadth is a touch better than it was in early summer. Bottom line for a diversified equity investor: stay invested with a **Quality-first** core and be open to measured small-cap and select industrial exposure while the curve keeps steepening. Keep an eye on inflation's short-term pulse and credit spreads; those will determine how much risk we want to take on the margins.

House view on risk: Neutral, with a positive bias if the next CPI and payrolls cooperate.

Figure 1. Regime Dashboard

Signal	Latest	What we're seeing	Portfolio takeaway
Manufacturing PMI (level)	48.7 (Aug)	Factories are still soft but not deteriorating; services remain in expansion, so overall growth is slower, not rolling over.	Stay invested with a Quality-first core ; avoid big bets on deep cyclicals until PMI is >50 and trending.
PMI 6-month change	-1.6 pts (Aug vs Feb)	Momentum over the last half-year is still slightly negative, which argues for patience on full "early-cycle" positioning.	Keep cyclical tilts measured ; scale up only if momentum turns positive.
CPI (3-month annualized)	~2.3% (thru Jul)	Short-run inflation keeps drifting lower - supportive for a "gradual easing" path and for multiples.	Comfortable to lean into quality/profitable growth and add cyclicals selectively while inflation cools.
Yield curve (10y-3m slope)	~+14 bps (Aug avg)	The curve is "healing," not yet "healthy." Early sign that financing conditions are less hostile.	Maintain a measured small-cap sleeve; add on further steepening rather than front-running it.
Credit Spreads (HY OAS)	~2.8-3.0% (late Aug)	Spreads are tight - risk appetite intact; no stress signal from credit.	Green light to stay invested ; if spreads widen quickly, trim cyclicals and raise defense.

What changed since last month?

Manufacturing PMI edged up to 48.7 in August from 48.0, while CPI's 3-month annualized pace eased to ~2.3% through July. The 10y-3m curve held roughly flat near +14 bps, and HY spreads hovered around 2.8-3.0%. Leadership broadened a bit- Industrials firmed; Health Care lagged. Importantly, the Fed's tone shifted toward near-term rate cuts, with markets pricing multiple reductions ahead.

Year-to-Date at a Glance

YTD returns are solid. Large caps continue to carry the torch, helped by durable profitability and balance-sheet strength, while international markets have been mixed to strong depending on currency and commodity exposure. Under the surface, leadership is still skewed toward higher-quality names, but the modest steepening of the curve is giving small caps a bit more breathing room.

Figure 2. Stock Markets Performance (as of 09/08/2025)

Rank	Sector	YTD %
SPY	S&P 500 ETF Trust	10.7
IWF	Russell 1000 Growth ETF	12.8
IWD	Russell 1000 Value ETF	9.81
IWM	Russell 2000 SML Caps	8.3
IEFA	Core MSCI EAFE ETF	25.3
EEM	Emerging Markets ETF	21.9

Source: Factset

Sector performance is uneven but informative. A handful of cyclical and tech-adjacent groups are still doing the heavy lifting, while a few defensives have slipped as rate-cut odds rise and bond yields stabilize. We'll use those gaps to decide where to harvest gains and where to add exposure.

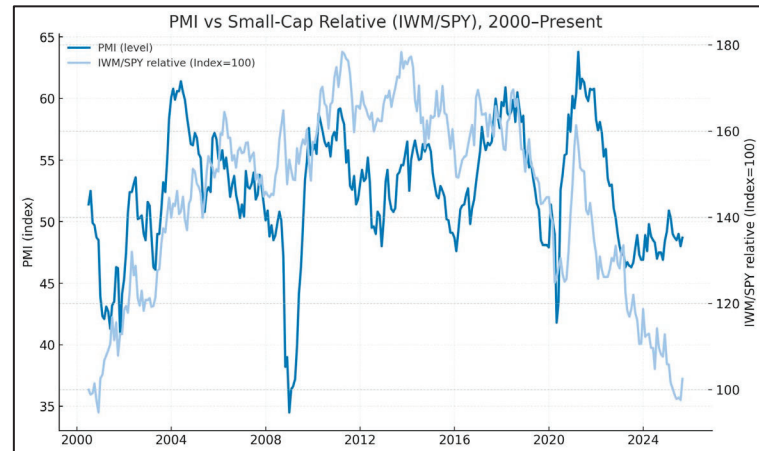
Figure 3. Select Sectors Performance (as of 09/08/2025)

Rank	Sector	YTD %
1	Communication Services	19.2
2	Industrials	15.2
3	Technology	14.3
4	Health Care	1.1
5	Consumer Staples	3.7
6	Real Estate	4.6

Source: Factset

Macro data continue to lean our way: Inflation is broadly steady to lower on a 3-month basis, and job growth is positive but moderating, and the yield curve is less hostile than it was. **None of this screams "boom," but together it supports a constructive stance.** The PMI vs Small-Cap Relative overlay (Figure 4) points to a nascent, credible leadership turn in small caps.

Figure 4. Small Caps Performance vs PMI



Source: ISM, Factset

Manufacturing is still below 50, but importantly improving, the classic "soft, but getting better" backdrop that has often preceded multi-month stretches of small-cap outperformance. You can see it in the chart: after July's dip, PMI bounced and the IWM/SPY line has been making higher lows, a telltale early-phase turn. Historically, these healing phases have more follow-through when macro co-drivers aren't hostile (credit spreads not widening, earnings revisions stabilizing), which broadly matches today's setup. The main caveat is a head-fake risk: if PMI momentum fades for a couple of prints, the relative uptick usually stalls.

Lower interest rate expectations often benefit small-cap stocks because they're more sensitive to short-term rate declines and domestic demand. When markets shift to a bull steepener (short rates fall more than long rates), small caps tend to outperform as financing costs drop and investor appetite broadens. The effect is strongest when easing is seen as precautionary (not crisis-driven) and credit conditions remain stable, supporting earnings outlooks. However, if rate cuts are driven by recession fears, small caps usually lag due to worsening fundamentals.

What's Changing

1) The Fed's tone has shifted toward easing

What: Markets and Fed commentary now lean toward a measured cutting path, contingent on continued disinflation and steady employment.

Why it matters: **Easing expectations typically broaden equity leadership** beyond mega-caps, supporting small caps (more rate-sensitive balance sheets) and cyclical groups when the backdrop is “slowing, not collapsing.” It also lowers the hurdle for international and more value-tilted exposures if the dollar softens alongside.

What to watch next: The next CPI and Payrolls prints and the FOMC statement: does guidance frame cuts as insurance (constructive for equities) or as a growth scare (less constructive)?

2) Manufacturing is still soft, but PMI is improving

What: The ISM Manufacturing PMI remains below 50 yet has inched higher from the July trough, classic “soft, but getting better.”

Why it matters: Our PMI vs. Small-Cap Relative overlay shows early **relative strength turning up for small caps when PMI momentum turns positive, especially from sub-50 levels**. Historically, these “healing” phases support small caps and cyclicals for 3–9 months, provided credit remains calm.

What to watch next: PMI momentum (3-month change) and whether services stay in expansion. Two more “green” PMI prints would strengthen the case that the small-cap rally has legs.

3) Earnings revisions have stabilized—breadth is no longer deteriorating.

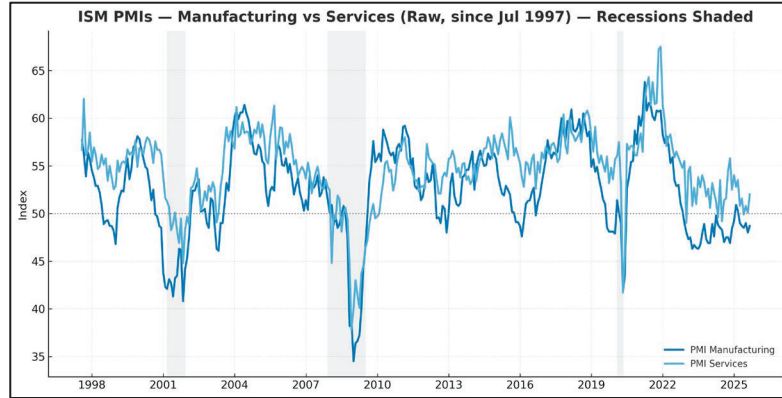
What: The drumbeat of downgrades from early summer has eased, and forward EPS is roughly steady.

Why it matters: **Stable or improving revisions breadth is the bridge from narrow mega-cap leadership to broader participation**. That backdrop tends to support mid/small caps and quality-cyclical exposures while keeping defensives more mixed.

What to watch next: Pre-earnings revisions season over the coming weeks and the sector mix of upgrades vs. downgrades. If breadth improves outside the mega-cap

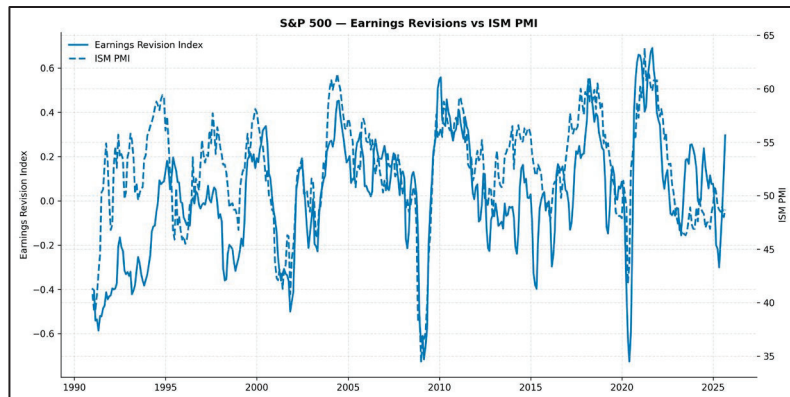
cohort, expect broader equity contribution to index returns.

Figure 5. PMI Manufacturing and PMI Services



Source: Institute for Supply Management

Figure 6. S&P 500 EPS Revisions and PMI Manufacturing



Source: Factset

Implications for Equity Allocations

Where we are now. The macro mix is supportive but not euphoric: manufacturing is below 50 yet improving, services remain in expansion, inflation's short-run pulse is easing, and the Fed's tone has tilted toward measured easing. Credit is not flashing stress. [That cocktail argues for staying engaged with equities while letting breadth widen beyond mega-caps.](#)

Small caps vs large caps

Read-through from PMI: The overlay of PMI vs Small-Cap Relative suggests this small-cap turn is early but credible. [Historically, "<50 & rising" PMI phases often precede multi-month catch-up as operating leverage and domestic demand expectations improve.](#)

What would strengthen the case: Two more PMI prints that keep the 3-month change positive, plus stable credit spreads and improving revisions breadth

What would weaken it: A quick PMI relapse (two consecutive declines), credit widening, or a sharp dollar rally that tightens financial conditions.

Cyclicals vs defensives

Signal mix: [An improving \(but sub-50\) PMI typically nudges performance toward economically sensitive groups,](#) while disinflation lowers the hurdle for multiples.

Risk checks: If near-term inflation re-accelerates or PMI momentum stalls, defensives usually regain their footing. Keep an eye on the Macro Snapshot and Regime Dashboard.

U.S. vs international developed

Growth & USD: Softer inflation and gradual easing are often USD-benign or slightly negative conditions that can help non-U.S. developed equities close some performance gap, especially where manufacturing cycles are also improving (Figure 7).

Watch: Currency (broad USD trend), PMI synchronization across regions, and energy/commodity sensitivities.

Emerging markets

Two-handed case: Easing expectations and a softer USD can be constructive, but EM's follow-through depends on global trade pulse, credit conditions, and policy clarity in

key countries.

Watch: USD trend, China-adjacent demand indicators, and HY OAS (a proxy for global risk appetite).

What upgrades/downgrades the current stance

Upgrade (broaden risk):

- PMI <50 & rising persists (2-3 months in a row).
- Earnings revisions breadth turns decisively positive outside mega-caps.
- Credit stays tight and USD is range-bound or softer.

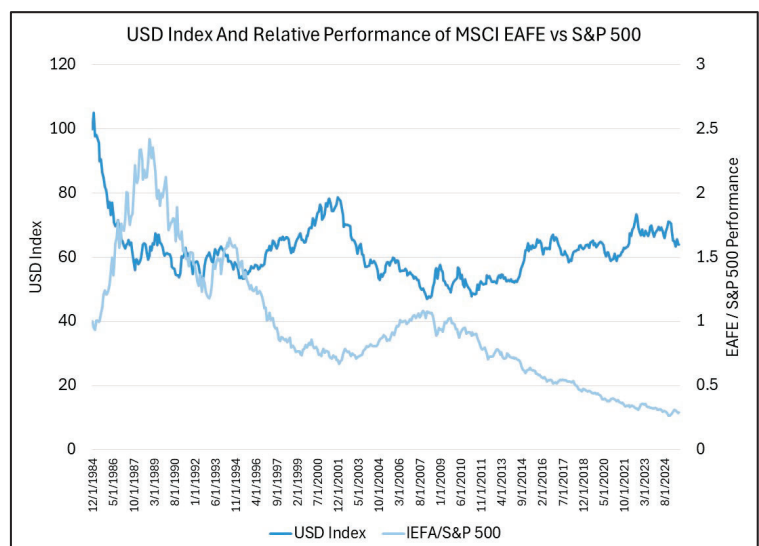
Downgrade (narrow risk):

- PMI momentum turns negative for two consecutive months.
- HY spreads widen meaningfully from recent lows.
- CPI turns up persistently, raising the bar for easing

Bottom line: The backdrop favors [broadening leadership](#) with small caps and cyclical sleeves gaining ground [if PMI improvement and calm credit persist.](#)

Keep the analysis anchored to PMI momentum, revisions breadth, credit, and the USD. Those four signals will tell us if this rotation has room to run or needs to be dialed back.

Figure 7. USD and Relative Performance of International Stocks (MSCI EAFE)



Source: Factset

Risks, What We're Watching, & Quick Glossary

Key risks to the current read.

- **PMI head-fake:** Sub-50 bounce fades; two weak prints in a row would undercut the small-cap turn.
- **Inflation re-acceleration:** Short-run CPI heats up, easing gets pushed out, USD firms - breadth narrows back to mega-caps.
- **Credit wobble:** HY OAS widens quickly (risk appetite deteriorates), small-cap beta underperforms.
- **Earnings slippage:** Revisions breadth turns negative again; forward EPS flattens or rolls over.
- **Policy/geopolitics:** Tariffs, fiscal uncertainty, or external shocks pressure margins/multiples.
- Bull vs. bear steepener: Curve steepens from short rates falling (bull) vs. long rates rising (bear); small caps prefer the former.
- MSCI EAFE: A stock market index that tracks the performance of large- and mid-cap equities in developed countries outside of the United States and Canada.

What we'll monitor into next month

- PMI Manufacturing & Services: level and 3-month change (is "<50 & rising" intact?).
- Inflation pulse: CPI YoY and CPI 3-mo annualized.
- Labor tone: Payrolls trend vs. revisions.
- Financial conditions: HY OAS, USD trend; 10y-3m slope.
- Earnings breadth: Net upgrades (Up – Down) / Total by size and sector.
- Market breadth: Small-cap relative trend (IWM/SPY), % of names above 50-day vs. 200-day.

Quick glossary (plain English)

- PMI: is the Purchasing Managers' Index from the Institute for Supply Management, a monthly economic indicator that measures the health of U.S. manufacturing or services. A reading above 50 indicates expansion of that sector's activity, while a reading below 50 signals contraction. The index is based on a survey of purchasing and supply executives regarding key business factors like new orders, production, employment, supplier deliveries, and inventories.
- Revisions breadth: Net share of analyst estimate upgrades vs. downgrades.
- HY OAS: High-yield credit spread over Treasuries; wider = tighter conditions.

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