

Party Like It's 1998

The Reber Report Q3 2025

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Shelby Davis—the U.S. ambassador to Switzerland under Presidents Nixon and Ford and a legendary investor who founded what eventually became Davis Funds—had a saying: “You make most of your money in a bear market, you just don’t realize it at the time.” In short, you build wealth by investing at the bottom, not chasing the herd at the top.

I would like to suggest a corollary to that proposition: *You lose most of your money in a bull market, you just don’t realize it at the time.*

With U.S. equity markets sitting at historically stretched valuations, it isn’t hard to see why many market commentators are drawing parallels to the tech bubble of the late-1990s. The similarities are not difficult to spot: large speculative flows into technology companies, valuations well above historical norms, a heavy concentration of returns in a handful of tech stocks, and now, as then, an easing of monetary policy to help keep the party going. Is history repeating itself?

No, but it might be rhyming. Coincidentally, the economic similarities to that period in economic history are striking. In September 1998, the Federal Reserve began cutting interest rates in response to a series of interrelated shocks: the Asian and Russian currency crises and the failure and bailout of the hedge fund Long-Term Capital Management. At the time, not unlike now, the unemployment rate in the U.S. was 4.6%, having crept up from 4.3% that spring. Much like today, real GDP growth in the second quarter of 1998 was relatively weak, at just 1.8%. However, unlike today, inflation was low—sitting at just 1.5%, down from 1.7% that spring. This economic backdrop gave the Greenspan Fed plenty of cover to cut its target Federal Funds Rate from 5.25% to 4.75% through the end of that year, stoking an already hot equity market and extending the rally until the bubble burst in March 2000.

Much like the developments of the past two weeks, Chairman Greenspan—despite his own warnings nearly two years earlier of “irrational exuberance” in equities—started cutting rates into a booming stock market. Similarly, the current Federal Reserve Chair, Jerome Powell, has started cutting rates with U.S. equity markets already at all-time highs, despite noting in a speech less

than a week later that “equity prices are fairly highly valued.” As it happens, the Greenspan Fed backtracked less than a year later, hiking rates by 150 basis points between June 1999 and May 2000 as the dot-com bubble gave way to frenzied speculation and ultimately collapsed in spectacular fashion between March 2000 and October 2002, surrendering nearly all of its gains from the prior five years.

Figure 1



Former Federal Reserve Chairman, Alan Greenspan, being rationally exuberant. (Courtesy of Business Insider and Reuters.)

This time is different. While current valuations are rich, we have not yet reached dot-com era extremes on some closely watched metrics. Additionally, unlike in the dot-com bubble, today’s market leaders—Nvidia, Microsoft, Alphabet, Amazon, and others—are highly profitable companies with strong cash flows and solid balance sheets. On the other hand, market concentration is even more extreme than it was at the height of the dot-com boom and the current economic situation is characterized by anemic GDP growth, sticky inflation, a stall-speed labor market, as well as record debt and fiscal deficits.

But the psychology of market bubbles hasn't changed. Much like in the late 1990s, investors today appear to be extrapolating the projected benefits of recent technological advances in perpetuity, bidding up the prices of a handful of companies as if the full promise of their boundless AI investments will be fully realized without the threat of competition, regulation, or cyclical slowdowns.

As with the development of the internet, there is no doubt that AI will fundamentally reshape our economy. However, while there is opportunity in the underlying technological revolution, the market's pricing of that opportunity may be far ahead of what firms can deliver in earnings and cash flows in the near term.

Today, like then, there is a sense among some market participants that traditional valuation metrics are obsolete and no longer apply to the new AI economy. That kind of rationalization is both false and dangerous. **Valuations are like gravity in financial markets.**

They may not always dictate the day-to-day movements of stock prices—just as gravity doesn't prevent a ball from being thrown into the air—but eventually they reassert themselves. Prices can continue to move higher for a time, propelled by momentum, liquidity, or investor enthusiasm, but the further they drift from their underlying fundamentals, the stronger the eventual pullback toward long term averages. **Gravity doesn't disappear simply because we choose to ignore it; it only waits patiently to remind us of its presence.**

The late 1990s provide a clear reminder of how quickly exuberance can give way to panic—and how steep the losses can be when it does. While it's always possible this proves to be the “crash that never comes,” the weight of the evidence suggests investors should be on high alert. This is a market where complacency could prove very costly. We believe investors should continue to exercise caution and invest with discipline.

U.S. Equity Markets Continue to be Overvalued

The FOMO rally in U.S. equities, which started in July and persisted throughout the summer, gained traction after Labor Day on hopes the Fed would cut rates. Following the 25-basis point cut on September 17th, markets have continued to grind higher to valuations that history suggests are unsustainable, even as GDP growth stagnates and the labor market weakens.

S&P 500 Cyclically-Adjusted P/E (CAPE) Ratio Figure 2

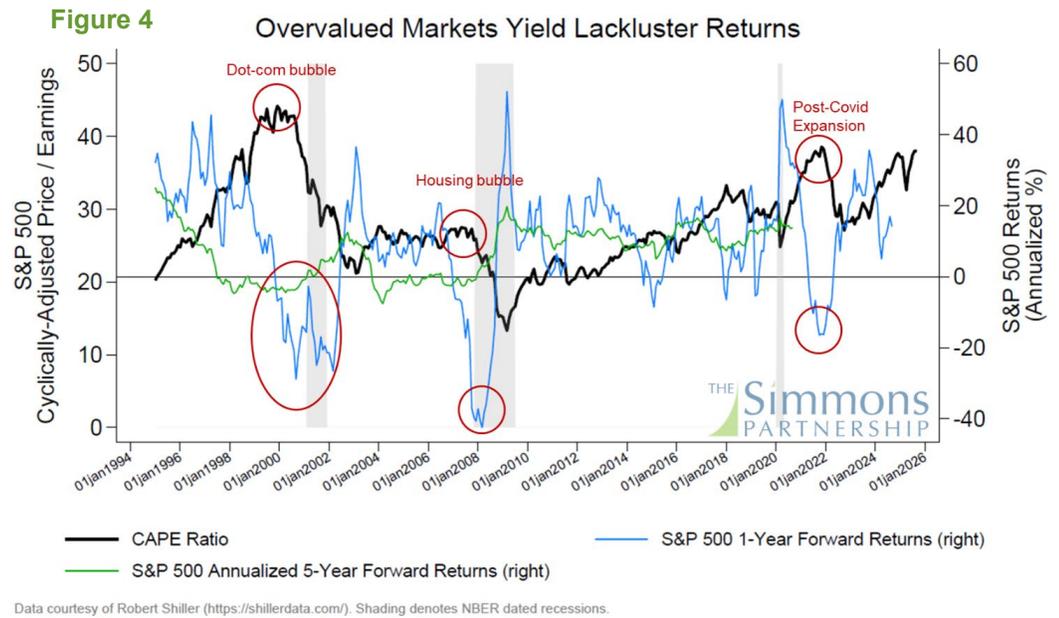


Figure 3 Buffett Indicator: U.S. Stock Market Value to GDP



Nearly every valuation measure we follow suggests the broad market is overvalued, with most metrics between one and two standard deviations above their 30-year average. Figures 2 and 3 illustrate this point using both the S&P 500 cyclically-adjusted P/E (CAPE) ratio and the ratio of total U.S. stock market value to GDP—the so-called Buffett Indicator.

As I have stressed previously: **fundamentals and valuations matter because they are tied to future returns.** Historically, when valuations have been stretched to their current levels equity markets have underperformed in subsequent years. Figure 4 plots the CAPE ratio against subsequent 1- and 5-year annualized returns on the S&P 500 index. **Over the past 30 years, whenever the CAPE ratio has been at its current level or higher, the subsequent 1- and 5-year returns on the S&P 500 have averaged -3.2% and -15.1% (-3.2% annualized), respectively.**



Current conditions suggest pairing smart, selective offense with defensive hedges. Not all stocks or sectors are overvalued—by sticking to our disciplined, value-oriented, investment process we continue to find good companies with strong balance sheets at attractive multiples. We are tactically hedging our equity exposure and keeping extra cash on the sidelines to cushion downside risks and take advantage of good values in equity markets as they arise.

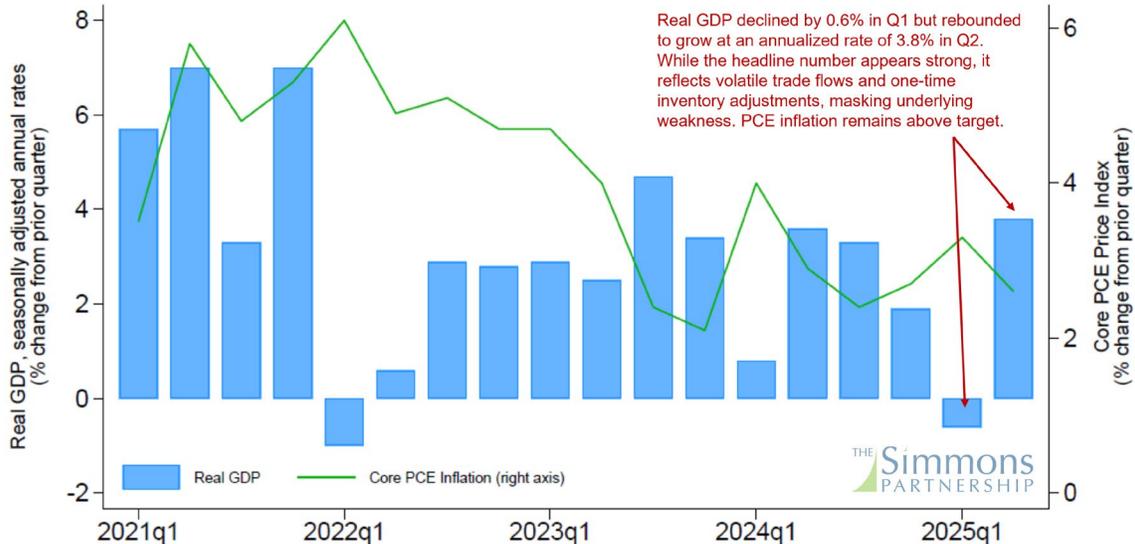
Headline GDP Numbers Mask Weak Economic Growth

As we close out the third quarter of 2025, the macroeconomic backdrop remains challenging. Consistent with my commentary since the beginning of the year (see our Market Insights [here](#)), economic statistics released over the past few weeks continue to tell the story of a decelerating labor market and relatively stagnant economic growth, haunted by the specter of persistently above-target inflation.

The final estimate of real GDP for Q2, released last Thursday, showed the economy growing at an annualized rate of 3.8% for the quarter—a robust growth rate and a marked upward

revision from earlier estimates. However, this seemingly strong growth in Q2 was driven primarily by volatile trade flows (notably, a sharp drop in imports) and one-time inventory adjustments, suggesting that underlying momentum is more fragile than the headline number implies. Notably, revisions to first quarter estimates showed the economy contracted at a rate of 0.6% in Q1, worse than the 0.3% initially reported. To put these statistics in perspective, **real U.S. GDP has grown by a meager 0.78% through the first half of this year. On an annualized basis, that's just 1.57%—far below potential.**

Figure 5 Strong Headline GDP Growth Masks Underlying Weakness, Inflation Remains Elevated

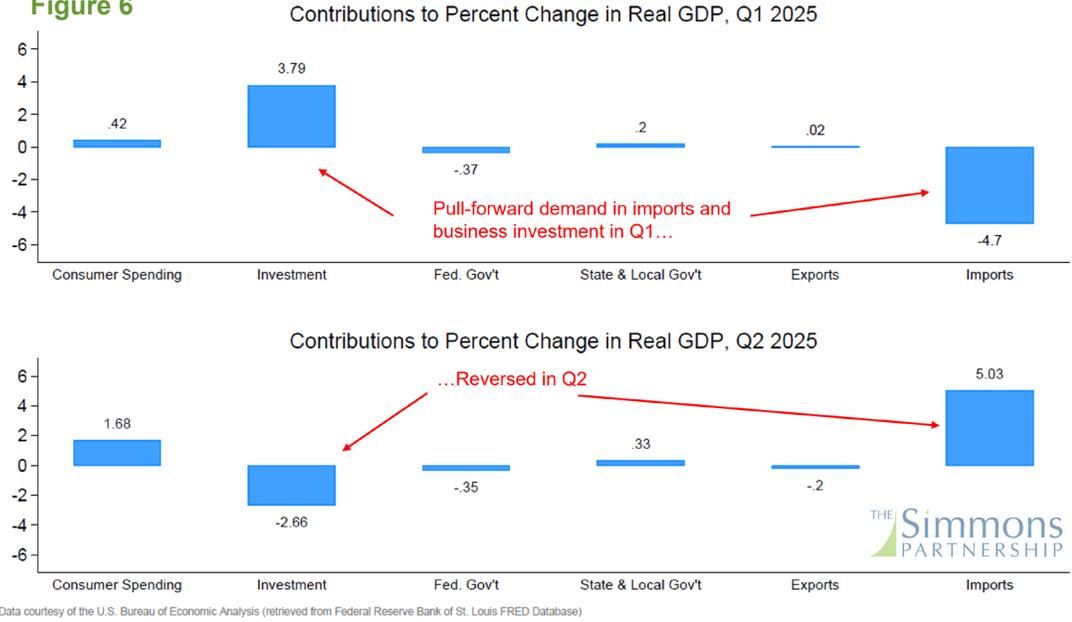


Data courtesy of the U.S. Bureau of Economic Analysis (retrieved from Federal Reserve Bank of St. Louis FRED Database)

As shown in Figure 6, contributions to Q2 real GDP growth were effectively the mirror image of what we saw in Q1. The spike in imports and business investment ahead of tariffs in Q1 led to a dearth of imports and a drawdown of business inventories in Q2, such that the effects were all but netted out. Despite a recent, notable, upward revision to consumer spending, domestic consumption (consumer spending plus gross private domestic investment) remains weak, subtracting 0.98 percentage points from real GDP growth in Q2.

Looking ahead, near-term GDP forecasts reflect further challenges over the next year.

Figure 6

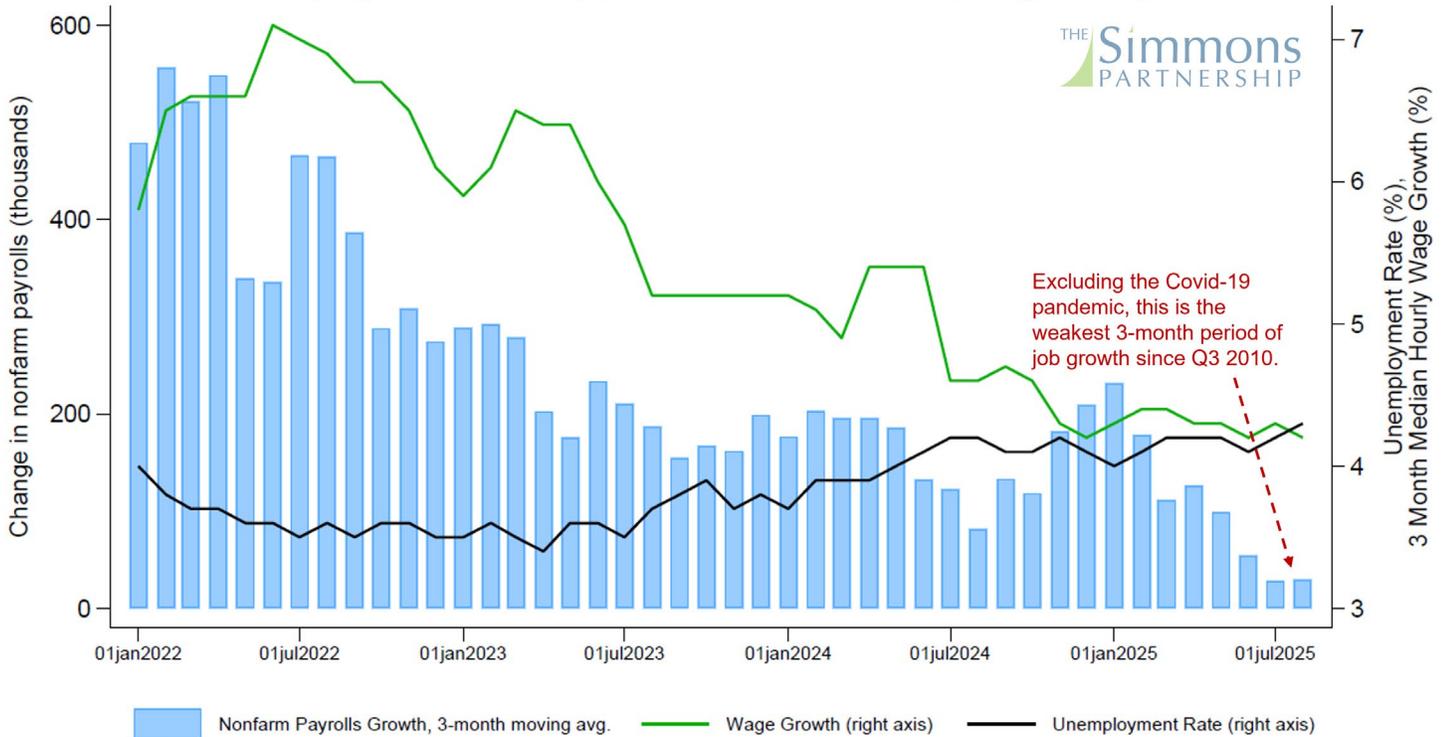


The [Federal Reserve Bank of Atlanta's GDPNow forecast](#) suggests another quarter of strong headline growth, with real GDP projected to increase at an annualized rate of 3.9%. [The Federal Reserve Bank of New York's Staff Nowcast](#) is slightly less optimistic, projecting an annualized growth rate of 2.5% in both Q3 and Q4. However, the median forecast from the [Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters](#) projects growth of just 1.3% in Q3 (1.7% for all of 2025), followed by 1.6% in 2026.

The Labor Market Remains Soft

As was the case last quarter, the labor market will continue to hold ticking up since June and currently sits at 4.3%. Beneath the surface, however, the labor market continues to show signs of fatigue. Over the past few months, employment numbers have continued to disappoint. The unemployment rate, though still reasonably low, has been steadily

Figure 7 Unemployment Ticks Up, Job Growth Plummet, Wages Stagnate



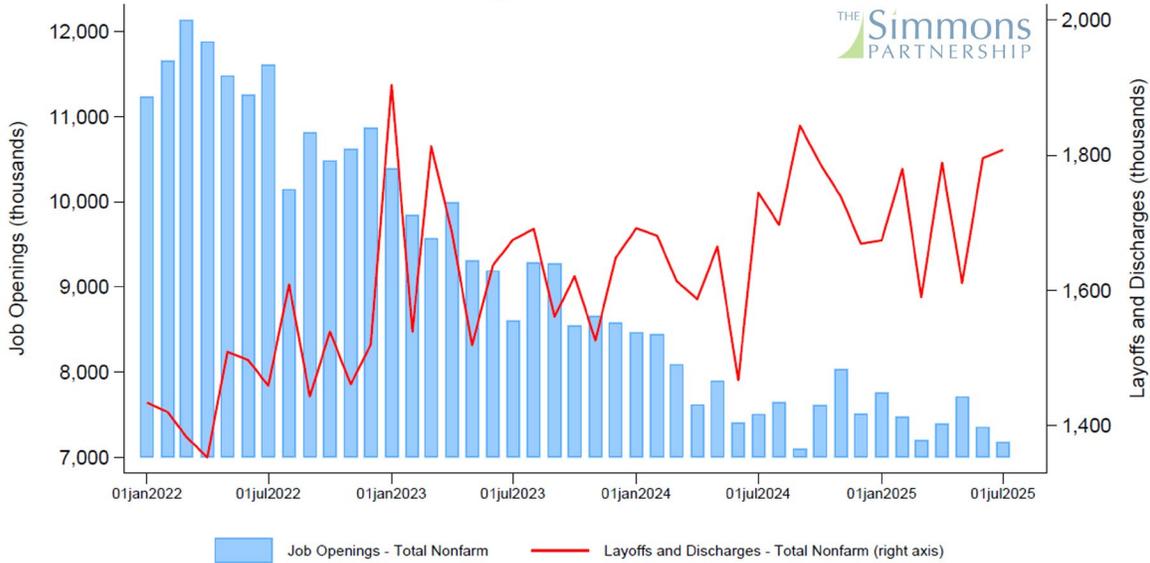
Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database).

In a shockingly bad labor report at the beginning of August, the U.S. Bureau of Labor Statistics (BLS) reported large downward revisions to prior statistics dating back to May. Based on the most recent estimates, the economy has added a mere 29,000 jobs per month on average since June—excluding the depths of the Covid-19 pandemic, that is the weakest 3-month stretch of job

growth since the third quarter of 2010.

Similarly, the number of job openings in the economy has steadily declined since the beginning of the year, as firms have scaled back hiring and layoffs have increased.

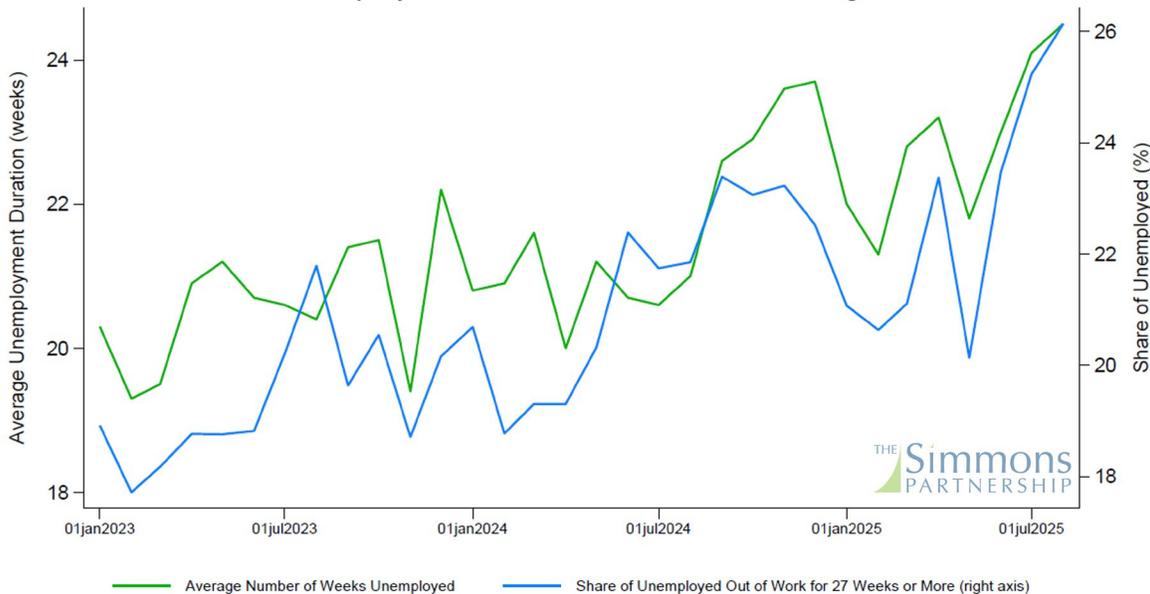
Figure 8 Weak Labor Demand: Job Openings Slump While Layoffs Continue to Rise



Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database).

At the same time, the average duration of unemployment has increased to 24.5 weeks (up from 22.0 weeks at the beginning of the year) and the share of unemployed persons out of work for 27 weeks or more has increased to 25.7% (up from 21.1% at the beginning of the year).

Figure 9 Unemployed Workers are Out of Work Longer



Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database).

Taken together, the employment data paints a picture of a labor market in which both the supply of and demand for workers has slowed. The unemployment rate is relatively low but has been ticking up over the past few months because the economy is creating jobs at a pace below the rate necessary to hold the unemployment rate constant.

Wage growth has stagnated. New graduates are having a hard time finding work and it's taking longer for unemployed workers to find new jobs. None of this is consistent with a robust economic expansion.

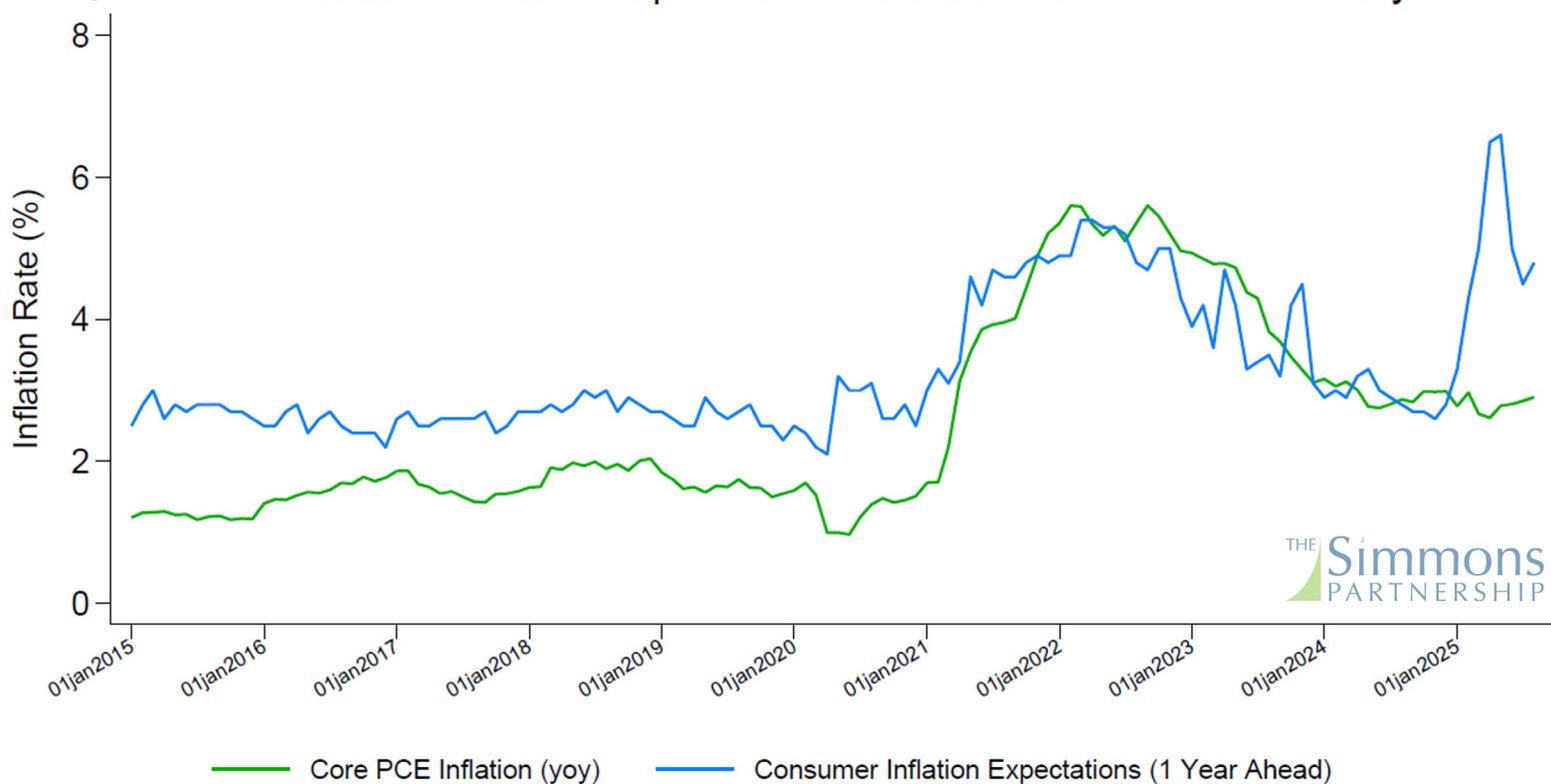
Inflation Remains Above Target

Though inflation has abated significantly from its highs in 2022, it has been stubbornly persistent since the middle of last year, fluctuating each month between 2.6% and 3.0% (annualized rates). Currently, core PCE inflation sits at 2.9%—above the Fed's 2.0% target. Meanwhile, consumers appear to be unmoved by the Fed's progress. According to the [University of Michigan Surveys of Consumers](#), inflation expectations remain disconnected from the current economic reality, with consumers expecting inflation over the next year on the order of 4.8% (see Figure 10).

As I have discussed in the past, this is important because consumer expectations of higher inflation can to some extent

become self-fulfilling—consumers, fearing higher prices in the future may pull forward demand, driving prices higher in the current period. Expecting prices to increase in the future, worker may react by demanding higher wages to offset price increases. Without more output (higher productivity) firms may pass those cost increases through to consumers in the form of higher prices, setting off a cycle of higher inflation expectations begetting higher inflation. Nevertheless, most market-based measures of inflation expectations over the next two to five years tend to be more consistent with long-term averages—in the range of 2.3% to 2.5%.

Figure 10 Consumer Inflation Expectations Remain Detached From Reality



Data courtesy of the U.S. Bureau of Economic Analysis and University of Michigan Surveys of Consumers (retrieved from Federal Reserve Bank of St. Louis FRED Database).

Fed Rate Cuts and the Inflation Gambit

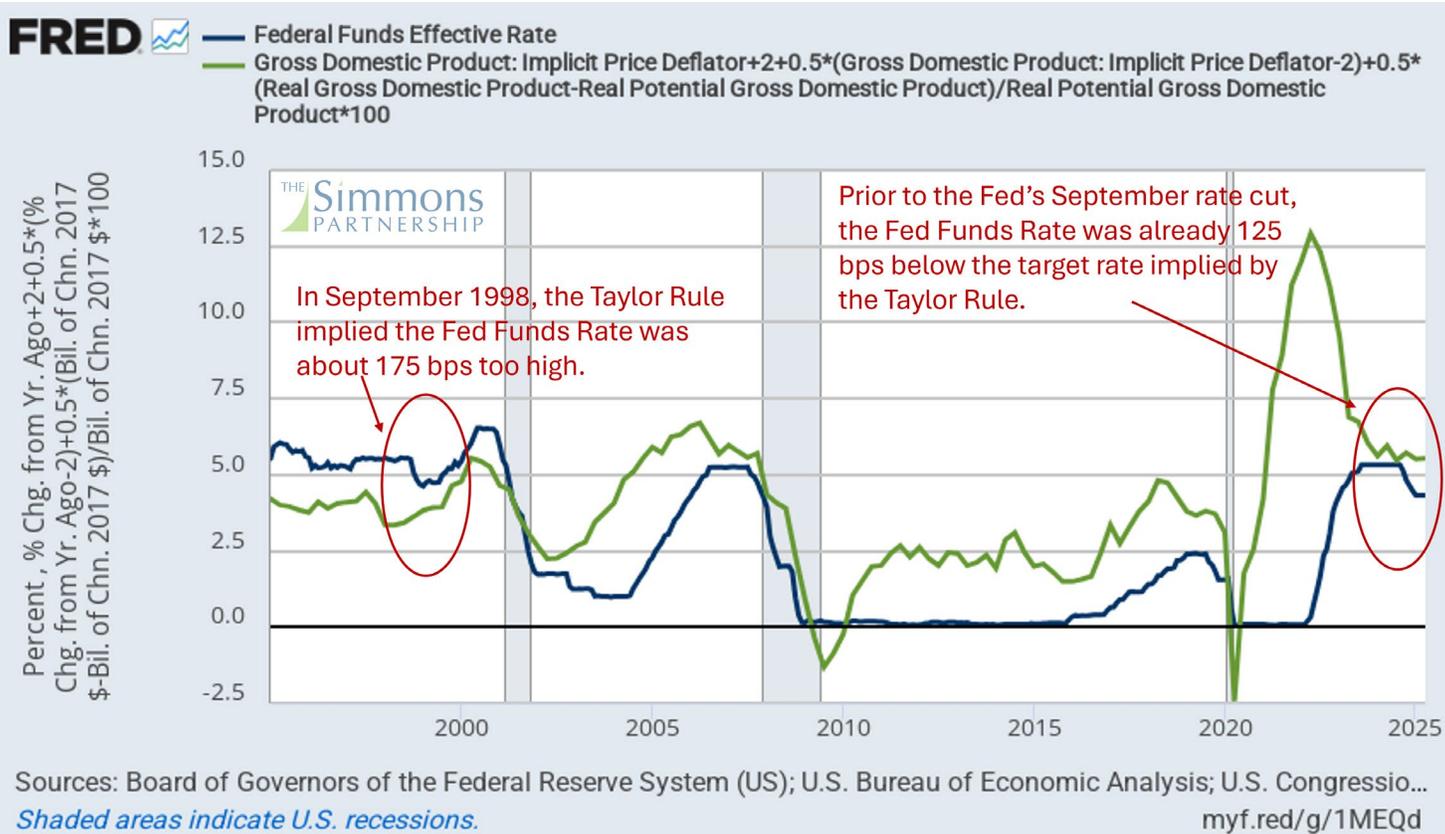
The Fed currently finds itself in a tight spot—economic growth has been weak, job gains have slowed, and inflation remains somewhat elevated. In a speech on September 23rd, Chairman Powell stated:

*Near-term risks to inflation are tilted to the upside and risks to employment to the downside—a challenging situation. **Two-sided risks mean that there is no risk-free path.** If we ease too aggressively, we could leave the inflation job unfinished and need to reverse course later to fully restore 2 percent inflation. If we maintain restrictive policy too long, the labor market could soften unnecessarily. When our goals are in tension like this, our framework calls for us to balance both sides of the dual mandate.*

Citing a shift in the balance of risks, the Fed has chosen to err on the side of supporting the labor market. On September 17th, the Fed cut its target rate (the Federal Funds Rate) by 25 basis points and markets seem to be pricing in at least two more cuts of that magnitude by the end of the year.

Still, it seems significant that the Fed has started running routes from its recession playbook. It's a gutsy move to cut rates while the Taylor Rule—a popular formulaic approach to monetary policy that links the Fed Funds Rate to inflation and economic growth—suggested monetary policy was already more accommodative than it needed to be, with the Fed Funds Rate about 125 basis points *too low* (see Figure 11). Coincidentally, this is exactly the opposite of Chairman Greenspan's situation in Q3 1998. Then, the Taylor Rule implied the Fed Funds Rate was approximately 175 basis points *too high*, lending further support to rate cuts.

Figure 11



The Fed can call it a “risk management cut” or a “mid-cycle adjustment,” but with inflation already above their stated 2% target, the decision to run the economy hot could have negative repercussions. Clearly the downside risks to the labor market have the Fed concerned enough to open with the inflation gambit. Only time will tell if this is a shrewd move or a policy misstep that will serve only to further fuel inflationary pressures and equity market speculation.

Party on!

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 If you ever get the feeling that the advice you're getting is being read from a script, we'd love to talk to you.

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