

Weekly Market Commentary

September 29, 2025

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Equity Market Melt-Up Cools as Government Shutdown Looms

U.S. equity markets have bucked the weak September seasonality trend (thus far) and rallied to fresh highs this month, with the S&P 500 holding onto a 2.8% monthly gain as of September 26. The melt-up has been underpinned by the Federal Reserve (Fed) delivering on rate cut expectations without any hawkish surprises, earnings optimism, and continued support of the artificial intelligence (AI) secular growth theme. Economic data has also mostly surprised to the upside this month, including last week's upward revision to second-quarter GDP (supported by an unexpected jump in consumer spending) and a drop in weekly jobless claims. Friday's Core Personal Consumption Expenditures Price Index (PCE, the Fed's preferred inflation gauge) matched expectations, while personal spending came in stronger than expected. However, the market appears to be transitioning back into a *good news is bad news* backdrop, where signs of economic strength dampen expectations for future rate cuts. The threat of a U.S. government shutdown and new tariff announcements from the White House acted as a further overhang, with investors de-risking throughout most of the week, leaving the S&P 500 with a modest loss of 0.3%.

On the Brink of a Shutdown

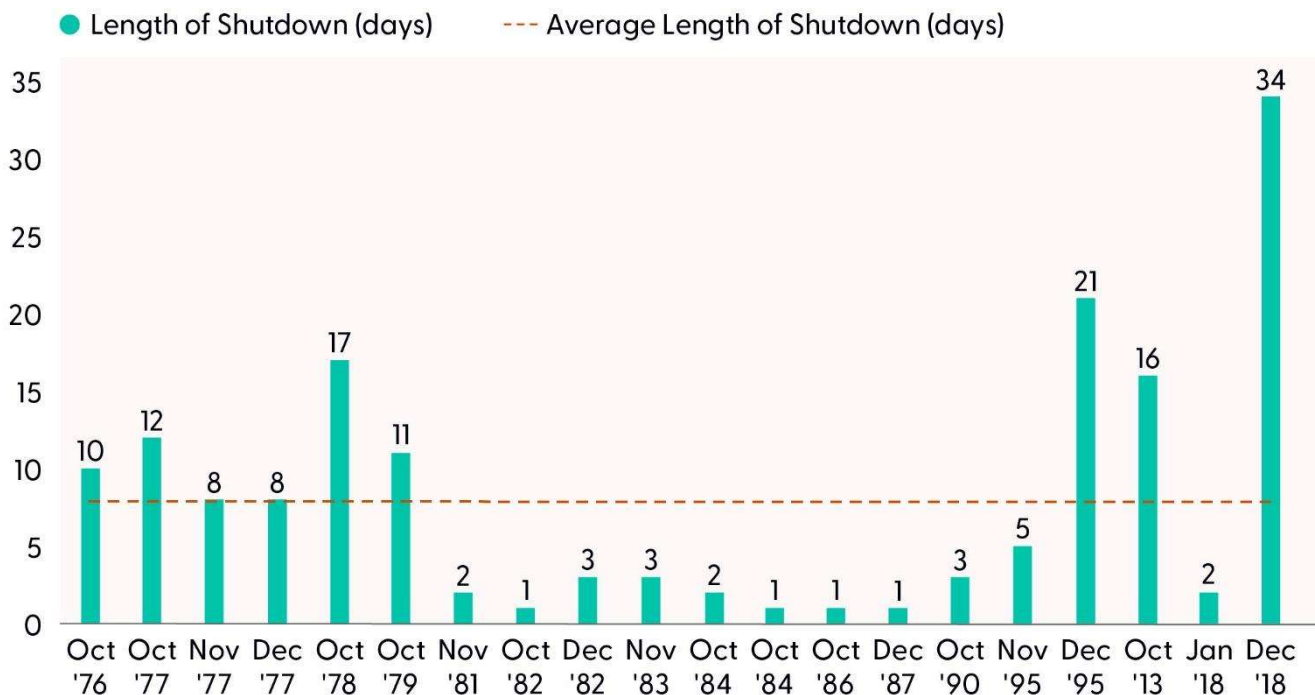
Congress has until October 1 to reach a deal to avoid a government shutdown, an unlikely scenario given the cancellation of a meeting on Thursday between President Trump, Senate Democratic Leader Chuck Schumer, and House Democratic Leader Hakeem Jeffries. Republicans have proposed voting on a "clean" seven-week continuing resolution, which would provide additional time for negotiations on full-year spending bills. Democrats insist they will not pass a spending bill unless it includes concessions on health care, including the rolling back of the White House's Medicaid cuts, and an extension of the Affordable Care Act insurance subsidies. In addition to furloughing workers during a potential shutdown, the Office of Management and Budget (OMB) announced last week that executive agencies should consider permanent cuts to federal employees working in discretionary areas "not consistent with the President's priorities." In terms of odds of a shutdown, the betting markets are pricing in a 63% probability (as of Sunday evening) of the government shutting down on Wednesday.

What Does a Shutdown Mean for Markets

Government shutdowns introduce a new layer of uncertainty for markets, but fortunately, they tend to be short-lived and, as a result, have had minimal impact on the economy. Investors have generally looked past budget-related disruptions, prioritizing corporate earnings, broader economic trends, and other key macroeconomic factors. However, sectors that depend heavily on government contracts — such as defense and life sciences — can be more sensitive to shutdowns. These areas often experience short-term pullbacks due to funding uncertainty but tend to outperform once government spending resumes. Additionally, a shutdown could result in delayed economic data releases, including this Friday's highly anticipated Employment Report.

As highlighted in the *Duration of Government Shutdowns* chart, the U.S. government has experienced 20 shutdowns since 1976. The average duration of those shutdowns was eight days, with the longest spanning 34 days from December 22, 2018, to January 25, 2019. Moreover, during the one- and three-month periods following the passage of a budget, the average one- and three-month returns for the S&P 500 were 1.2% and 2.9%, respectively.

Duration of Government Shutdowns



Source: LPL Research, U.S. House of Representatives 09/25/25

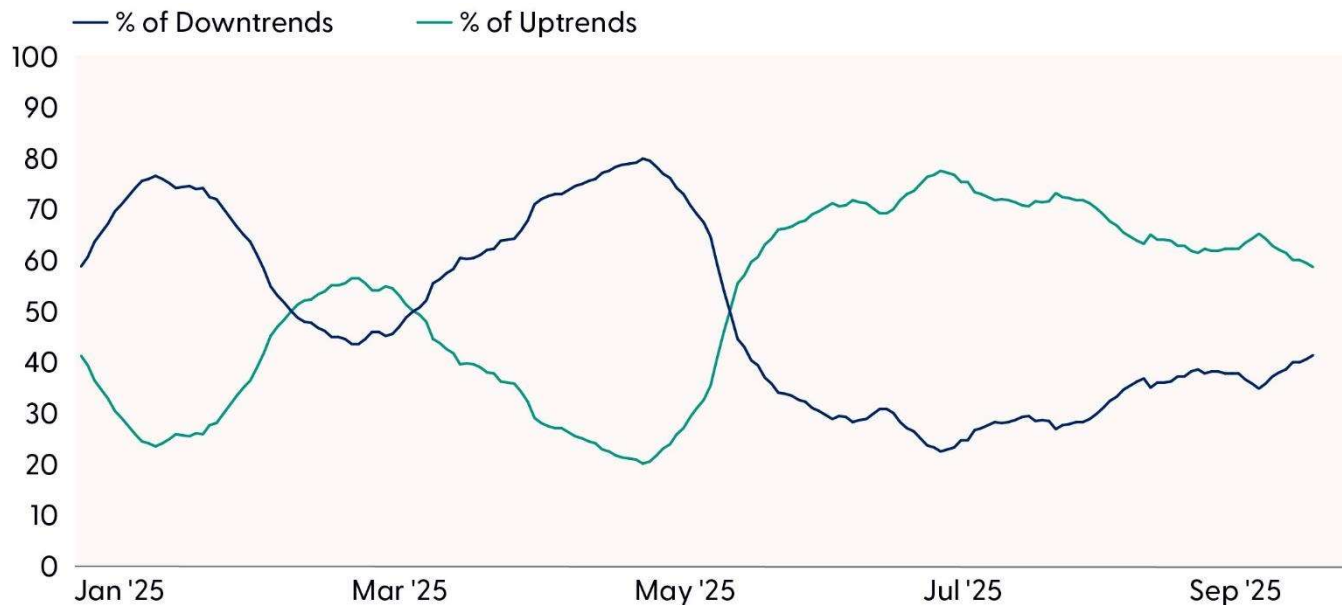
Disclosure: Data includes shutdowns/funding gaps from 1976–YTD. Only 1/4 of the government was shutdown from December 2019–January 2019

Sliding Into Month End

While a potential government shutdown may be impacting price action across markets, there is building evidence that the rally in stocks could be due for a breather. It has been an impressive run since the April 8 low, with the S&P 500 amassing a gain of over 30% with minimal drawdowns along the way. However, overbought conditions have developed as the broader market recently reached an 11% premium to its closely watched 200-day moving average (dma), marking the highest reading since December 2024. Furthermore, participation in the latest leg higher has been underwhelming.

As highlighted in the *Internal S&P 500 Trends Are Weakening* chart, our proprietary trend model, which utilizes positioning across short-, intermediate-, and longer-term moving averages, reveals that fewer and fewer S&P 500 stocks are trading in uptrends. In contrast, the percentage of stocks in downtrends continues to increase. Perhaps even more concerning is the deteriorating trends within the technology sector, which holds a 33.5% weight within the S&P 500. As of September 26, only 53% of tech stocks were trading in an uptrend, a marked slowdown from the 80% reading reached in early August. As a reminder, the tech sector has consistently led the broader market, both on the way up and on the way down. Therefore, any pullback in the sector has the potential to drag the rest of the market down with it.

Internal S&P 500 Trends Are Weakening



Source: LPL Research, Bloomberg 09/25/25

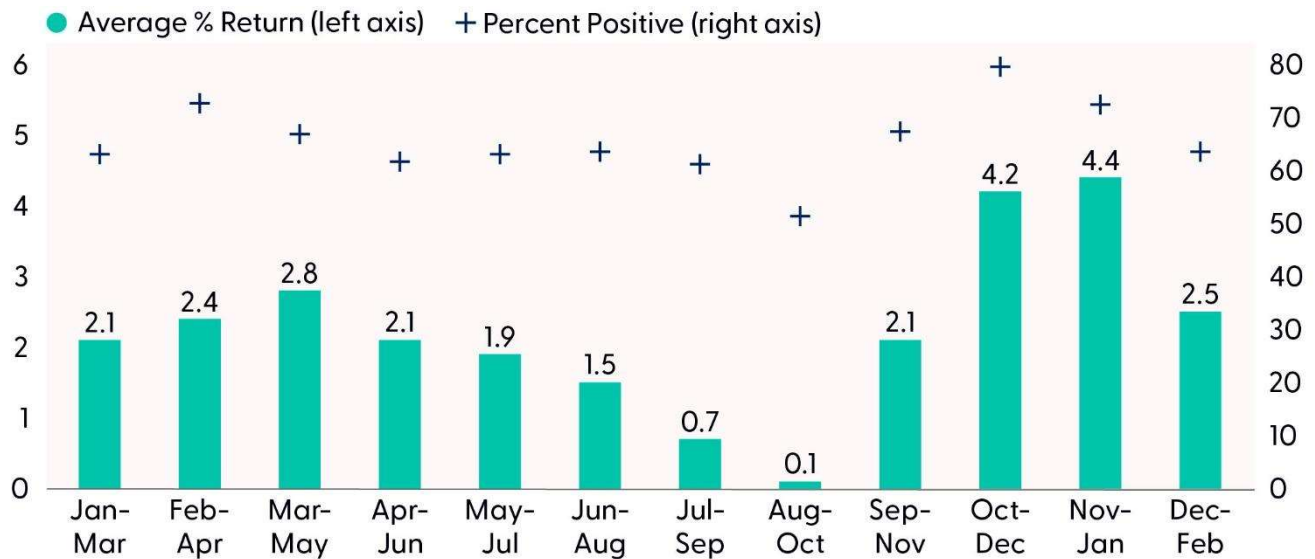
Disclosure: Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results. Trend definitions defined by the relationship between the 21-, 63-, and 126-day moving averages.

Silver Lining Playbook

While we believe the odds for a pullback (5–10% drawdown) are rising, there is a silver lining. First and foremost, we don't think the bull market is at risk of ending. Strong earnings, a good enough economy, the resumption of the rate-cutting cycle, runway for AI spending and its potential productivity gains, and stimulative measures from the One Big Beautiful Bill Act (OBBBA) are a few of the many catalysts that should keep this bull market alive. Second, although some shorter-term technical cracks have recently developed, the S&P 500 remains in an uptrend driven by consistent cyclical leadership. Third, a pullback could reset overbought conditions and allow fundamentals to catch up with price. Finally, and perhaps most importantly for investors, a pullback would provide a tactical opportunity to buy into a seasonally strong period.

October marks the beginning of one of the best three-month periods for stocks. Since 1950, the S&P 500 has generated an average gain of 4.2% from October through December, with 80% of periods producing positive results. And when results are positive, the average gain increases to 7.0%, compared to a 6.7% decline when the three-month window is negative.

S&P 500 3-Month Return Windows (1950-YTD)



Source: LPL Research, Bloomberg 09/25/25

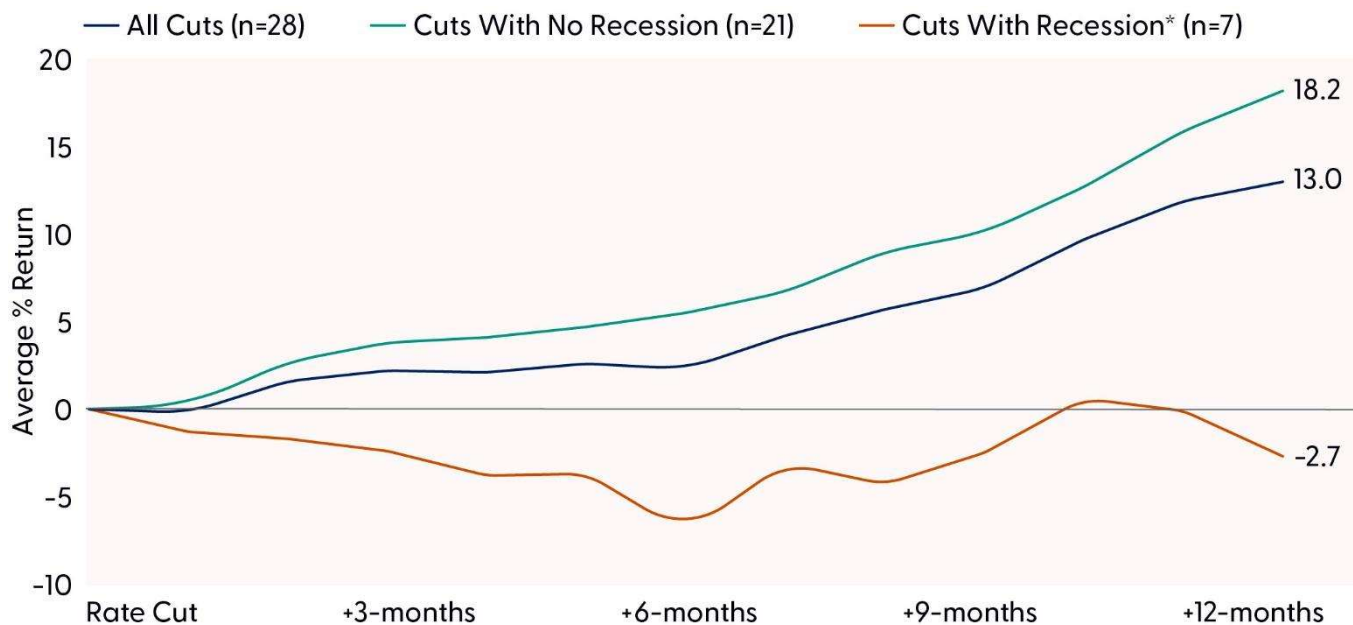
Disclosure: Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Don't Fight the Fed

The Fed delivered a highly anticipated 0.25% interest rate cut during its September 16-17 meeting of the Federal Open Market Committee (FOMC). Fed Chair Powell said the move should be viewed as a “risk-management cut” in response to signs of a weakening labor market. Policymakers also penciled in two additional 0.25% interest rate reductions for 2025, as well as an additional 0.25% cut by year-end 2026. With this major risk-clearing event in the rearview mirror, investors are now asking what happens next.

For stocks, history suggests that the path ahead is likely higher, based on previous instances when the Fed cut rates when stocks were trading near or at record highs, although past performance is no guarantee of future results. Since 1984, the Fed has cut rates 28 different times when the S&P 500 was within 3% of an all-time high. After the cut, the broader market traded higher by an average of 13.0% 12 months later, with 93% of periods producing positive returns. When there was no recession near or during the rate cut (we filtered for cuts occurring at least six months prior to a recession), the average 12-month return for the S&P 500 increased to 18%, with 21 out of 21 periods producing positive results. When a recession overlapped near or during a rate cut, the market posted an average loss of 2.7% in the 12 months after the Fed reduced rates, with only 25% of periods generating a gain.

S&P 500 Performance After Fed Cuts Rates At/Near Record Highs



Source: LPL Research, Bloomberg 09/25/25

Disclosure: All indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results. At/Near record highs defined as periods when the S&P 500 was within 3% of an all-time high. Data based on dates from 1984-YTD. *Cuts with recession are defined as Federal Reserve interest rates occurring within six months of a recession

Summary

While a potential government shutdown could dampen investor sentiment, they tend to be brief and have limited impact on the broader economy or equity markets. From a technical perspective, it is hard to argue with a bull market that is making new highs and powered by cyclical leadership. However, recent overbought conditions paired with diverging market breadth suggest this melt-up could be due for some cooling off — something we would consider as a potential tactical opportunity to buy the dip, especially into a seasonally strong fourth quarter.

The restart of the Fed's rate-cutting cycle — especially with equities trading near record highs — has also been a constructive signal for markets. Still, the recent deterioration in labor market data raises concerns. The end of a long streak of positive monthly payroll prints serves as a cautionary marker, particularly if recession risks begin to build.

At this stage, LPL Research views near-term recession risk as relatively low. Our base case calls for an economy that continues to muddle through, with potential upside to GDP growth supported by a lower fed funds rate, stimulative measures from the One Big Beautiful Bill Act (OBBBA), and productivity gains amid easing cost pressures.

Asset Allocation Insights

LPL's Strategic and Tactical Asset Allocation Committee (STAAC) maintains its tactical neutral stance on equities. Investors may be well served by bracing for occasional bouts of volatility given how much optimism is reflected in stock valuations, lingering tariff and inflation risks. STAAC's regional preferences across the U.S., developed international, and emerging markets (EM) are aligned with benchmarks. The Committee still favors growth over value, large caps over small caps, and the communication services and financials sectors.

Within fixed income, the STAAC holds a neutral weight in core bonds, with a slight preference for mortgage-backed securities (MBS) over investment-grade corporates. The Committee believes the risk-reward for core bond sectors (U.S. Treasury, agency MBS, investment-grade corporates) is more attractive than plus sectors. The Committee does not believe adding duration (interest rate sensitivity) at current levels is attractive and remains neutral relative to benchmarks.

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The Standard & Poor's 500 Index (S&P500) is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

All index data from FactSet or Bloomberg.

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