

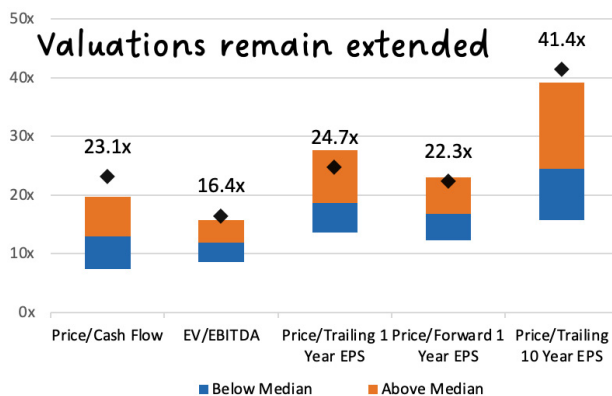


Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Tim Paulin, CFA

September 11, 2025

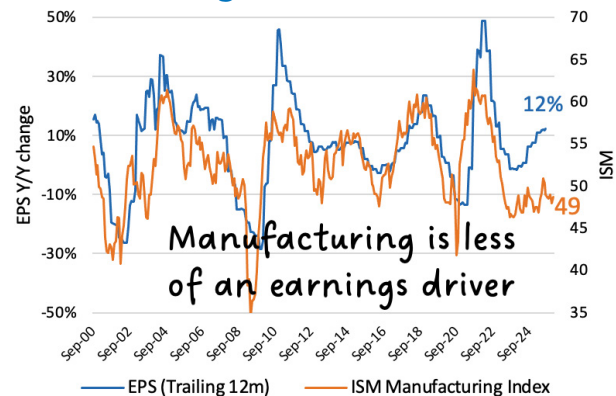
- ▶ We are maintaining a neutral stance on large cap blend equities. We see near term risks for the market, though absent a recession, we don't see conditions for a bear market.
- ▶ We expect market volatility to increase this fall, with both upside and downside risks increasing. September has historically been the weakest month for the S&P 500, and a correction is possible. Still, looking towards 2026, we see several positives that temper the downside case.
- ▶ Our forecast has called for slower economic growth in the second half, and recent data support this view. The past two employment reports fell well short of expectations and align with weaker survey data. Importantly, softer labor conditions appear to stem more from slower labor force growth, driven by immigration and tariff policies, than from layoffs, which would be more concerning.
- ▶ We expect the Fed to restart cutting rates in September at a gradual pace. Historically, mid-cycle rate cuts are positive for stocks, but we must weigh how much has already been priced in (U.S. stocks have set more than 20 all-time highs this year) and whether the cuts will prove to be as stimulative as expected; we have our doubts, given the apparent lack of economic rate sensitivity over the last couple of years.
- ▶ Looking ahead to 2026, a more accommodative Fed, tax cuts from the One Big Beautiful Bill, the World Cup, and the 250th anniversary celebrations should provide some tailwinds for stocks. They will be needed to offset continued headwinds from tariffs and slowing labor force growth.
- ▶ 2Q S&P 500 earnings growth came in much better than expected, up ~13% year/year. However, only three sectors had greater earnings growth than the S&P 500. Tech and AI-related companies continue to be the main story for market earnings. Looking forward, earnings growth for stocks outside of the Technology sector are expected to accelerate, and earnings revisions for the remainder of the year are beginning to move higher.

S&P 500 Index Valuation Ranges



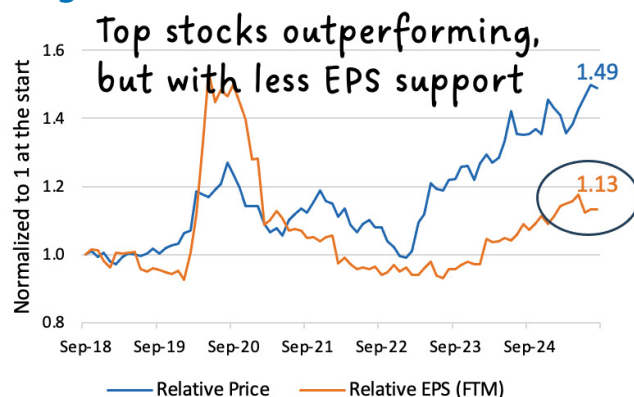
Source: Bloomberg. Based on monthly observations starting in 1996. The minimum and maximum ranges are set to the 5th and 95th percentiles, respectively, to remove outliers. Average percentile rank: 95% as of Aug 2025

S&P 500 Index EPS and ISM Manufacturing



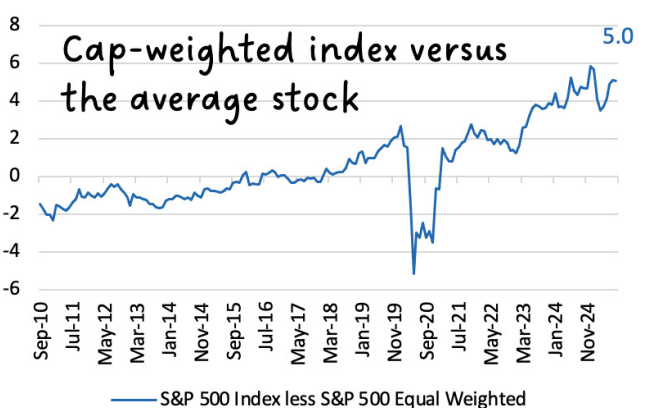
Source: Bloomberg. 26 years of monthly data through August 2025. ISM advanced 5 months.

S&P Top 50 Index versus S&P 500 Equal Weighted Index



Source: Bloomberg. 7 years of monthly data through Aug 2025

Forward P/E Multiple Difference



Source: Bloomberg. 15 years of monthly data through Aug 2025

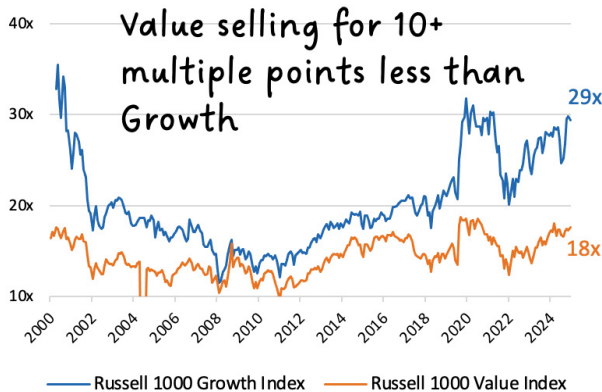


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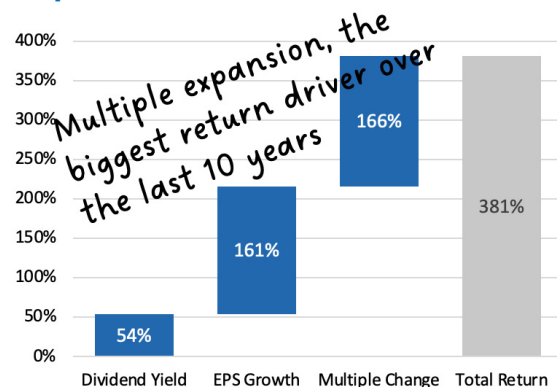
- ▶ We tactically hold a moderate underweight in Growth and remain neutral on Value.
- ▶ The growth underweight reflects both high valuations and concentration risk. Just five stocks now make up 46% of the Russell 1000 Growth Index. These stocks are heavily tied to AI, leaving index performance highly dependent on AI.
- ▶ So far, the AI story has been about model progress and capacity expansion, and it has been dramatic. Bloomberg estimates that 1H real GDP growth of 1.4% would have been closer to 0.4% without AI-driven investment. Much of this spending is to meet strong demand. We believe that the adoption of AI will continue to grow rapidly, and its economic impact will broaden. According to FactSet, AI mentions during S&P 500 earnings calls jumped up 32% from the prior quarter. By sector, mentions of AI increased the most for Financials and Industrials. These two Value sectors are among the most likely to be impacted by AI, given that the work is repetitive, data rich, high volume, and rules based.
- ▶ While we are bullish on AI, we believe that AI stocks already reflect a bullish outlook, but that doesn't mean they can't continue to rally. Over the next couple of years, we envision three distinct paths for AI and the markets, two of them suggest a broadening of market returns beyond the current AI stalwarts.
 1. **Broad Productivity Gains:** AI lowers costs across industries, extending benefits beyond today's leaders.
 2. **Cost of Doing Business:** AI adoption becomes essential but is mostly a cost of doing business needed to stay competitive. While there is likely to be some productivity gains, the main beneficiaries remain the owners of AI technology. While there will be winners from applying AI technology, returns are likely to be more dispersed beyond the current leaders.
 3. **Slower Model Progress:** AI use continues to grow, but not to the extent needed to support many of the valuations seen in the AI leaders.
- ▶ Another risk for Growth is a potential loss of Fed independence, which could push long term rates higher, pressuring Growth stocks, given they are longer-duration assets.

Price/Earnings Ratios: Forward 12 Months



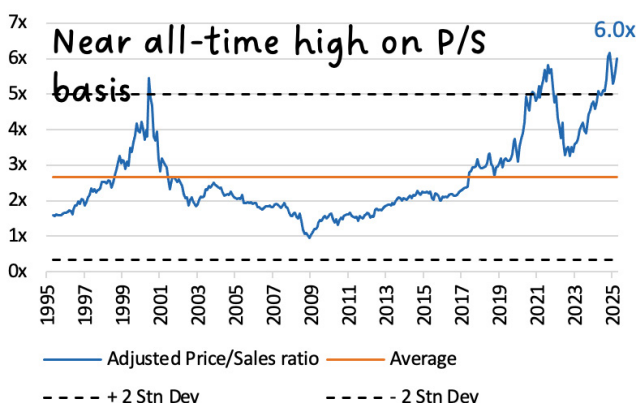
Source: Bloomberg. 25 years of monthly data through Aug 2025

S&P 500 Growth Index Return Composition



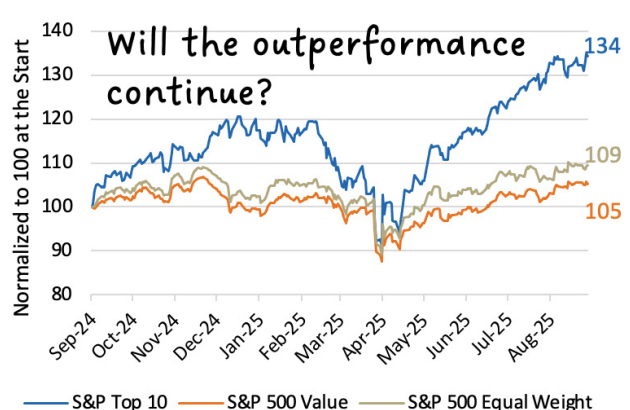
Source: Bloomberg. Cumulative total returns over the last 10 years through Aug 2025

Russell 1000 Growth Index



Source: Bloomberg. 30 years of monthly data through Aug 2025

1 Year Price Returns



Source: Bloomberg. 1 year of daily data through Sep 05 2025

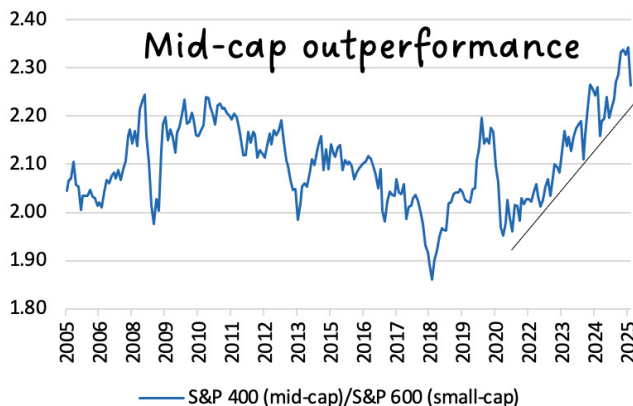


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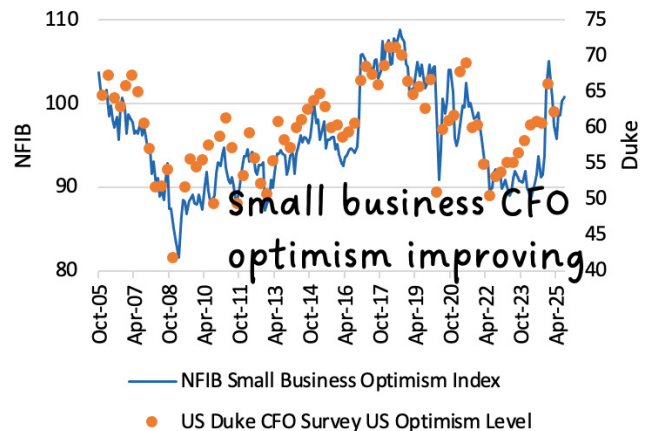
- ▶ We favor mid caps over small caps, which we see as offering the best risk/reward balance in the current market.
- ▶ Both segments outperformed in August on rising expectations for a September rate cut, with small caps posting the strongest gains. That said, we remain cautious about the durability of small cap outperformance given their higher economic sensitivity to economic conditions and our lack of conviction in a meaningful economic rebound. Assuming the Fed maintains its independence, we expect the rate cutting cycle to be gradual and only modestly supportive for growth. Still, lower rates should provide some relief, and sentiment among small business CFOs has been improving. Our view on small caps is not negative – only that, as with all investing, our views are relative to other investment opportunities.
- ▶ Historically, small and mid cap indexes traded closely, but that relationship has decoupled over the past 5 years as mid-caps outperformed. Several factors help explain this shift:
 - **Structural & Sector Differences:** Mid caps have greater exposure to Industrials, Tech, and Health Care, sectors that have benefited from both structural and cyclical tailwinds. Small caps are more heavily weighted toward low-growth cyclicals and financials, which are struggling amid rate volatility and tighter credit. This sector tilt gives mid caps a higher exposure to quality and growth factors
 - **Superior Profitability & Financial Strength:** Mid caps now exhibit operating margins and ROEs that are nearly double those of small caps, an important divergence from the pre-2019 norm.
- ▶ In terms of sector diversification and profitability, Mid caps are increasingly resembling the equal-weighted S&P 500, yet they continue to trade at a discount. We believe that mid caps may offer a compelling substitute for broad large-cap exposure, particularly for investors seeking diversification, quality, and valuation.
- ▶ In a slower growth economy with uncertain policy direction, we believe mid caps offer a more attractive balance of opportunity and risk. While small caps may outperform in a sharp recovery or aggressive Fed easing cycle, we believe mid caps present a better quality-for-risk tradeoff in the near term.

Relative Price Performance



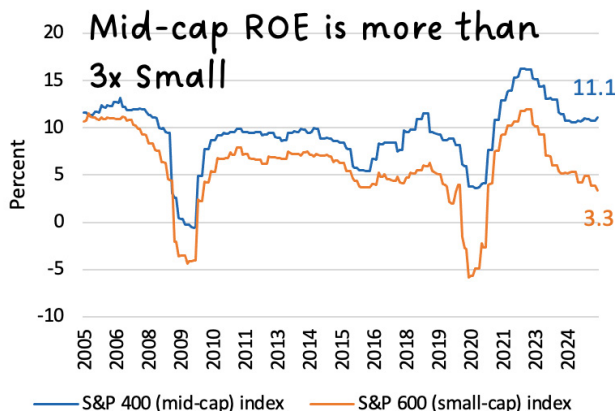
Source: Bloomberg. 20 years of monthly data through Aug 2025

CFO Optimism Surveys



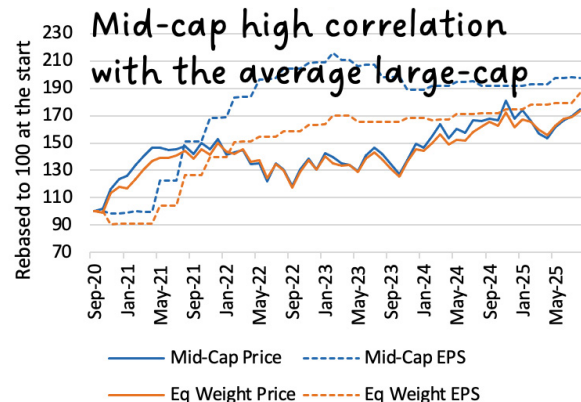
Source: Bloomberg. 20 years of observations. NFIB has monthly data through Mar 2025. Duke has quarterly data through Dec 2024.

Return on Common Equity



Source: Bloomberg. 20 years of monthly data through Aug 2025

S&P 400 vs. S&P 500 Equal Weighted



Source: Bloomberg. 5 years of monthly data through Aug 2025. EPS measured over rolling trailing 12 months.



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The Indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible.

Total Returns								
	August 2025	YTD	2024	2023	2022	2021	EPS Growth Estimate	
							2025	2026
S&P 500 Index	2.0%	10.8%	25.0%	26.3%	-18.1%	28.7%	9%	12%
S&P 500 Index Equal Weighted	2.7%	8.7%	13.0%	13.8%	-11.5%	29.6%	5%	11%
S&P 500 Value Index	3.4%	7.8%	12.3%	22.2%	-5.3%	24.9%	5%	10%
Russell 1000 Value Index	3.2%	10.0%	14.4%	11.4%	-7.6%	25.2%	5%	10%
S&P 500 Growth Index	0.8%	13.5%	36.1%	30.0%	-29.4%	32.0%	15%	15%
Russell 1000 Growth Index	1.1%	11.3%	33.4%	42.7%	-29.1%	27.6%	11%	17%
S&P 400 Index	3.4%	5.3%	13.9%	16.4%	-13.1%	24.8%	2%	17%
S&P 600 Index	7.1%	3.2%	8.7%	15.9%	-16.1%	26.8%	2%	19%
Russell 2000 Index	7.1%	7.1%	11.5%	16.9%	-20.4%	14.8%	-1%	21%

Valuations								
	P/E (TTM)	Percent Rank	P/E (FTM)	Percent Rank	P/CF	Percent Rank	P/S	Percent Rank
S&P 500 Index	26.8x	90%	21.5x	93%	23.1x	99%	3.3x	100%
S&P 500 Index Equal Weighted	20.9x	78%	16.6x	82%	13.7x	92%	1.7x	81%
S&P 500 Value Index	21.6x	94%	17.8x	99%	18.3x	95%	2.2x	100%
Russell 1000 Value Index	20.6x	89%	16.8x	93%	17.1x	97%	2.1x	98%
S&P 500 Growth Index	33.9x	93%	26.3x	94%	29.8x	99%	6.3x	98%
Russell 1000 Growth Index	38.4x	89%	28.5x	89%	31.0x	99%	6.3x	100%
S&P 400 Index	19.4x	33%	15.3x	51%	11.8x	62%	1.4x	90%
S&P 600 Index	22.1x	50%	14.3x	33%	11.9x	46%	1.2x	92%
Russell 2000 Index	58.4x	91%	21.4x	73%	15.7x	87%	1.4x	93%

Fundamentals								
	Dividend Yield	Percent Rank	Profit Margin	Percent Rank	ROE	Percent Rank	Net Debt / EBITDA	Percent Rank
S&P 500 Index	1.2%	5%	13.5%	98%	18.4%	94%	1.6	39%
S&P 500 Index Equal Weighted	1.8%	55%	9.1%	68%	11.6%	57%	2.6	59%
S&P 500 Value Index	1.9%	13%	10.9%	96%	14.1%	90%	2.1	41%
Russell 1000 Value Index	1.9%	6%	11.0%	92%	12.9%	66%	2.1	20%
S&P 500 Growth Index	0.6%	11%	20.2%	98%	29.2%	85%	0.7	27%
Russell 1000 Growth Index	0.5%	5%	17.9%	99%	36.9%	97%	0.6	8%
S&P 400 Index	1.5%	44%	8.1%	86%	11.2%	66%	2.5	44%
S&P 600 Index	1.7%	81%	7.0%	94%	3.3%	9%	4.2	90%
Russell 2000 Index	1.4%	42%	4.2%	53%	0.3%	20%	4.7	86%

For Index Definitions see: [TouchstoneInvestments.com/insights/investment-terms-and-index-definitions](https://touchstoneinvestments.com/insights/investment-terms-and-index-definitions)

Source: Bloomberg. Percent ranks are based on 30 years of monthly data as of the end of August; EPS growth estimates based on consensus bottom-up analyst estimates



The Touchstone Asset Allocation Committee (TAAC) consisting of Crit Thomas, CFA, CAIA – Global Market Strategist, Erik M. Aarts, CIMA – Vice President and Senior Fixed Income Strategist, and Tim Paulin, CFA – Senior Vice President, Investment Research and Product Management, develops in-depth asset allocation guidance using established and evolving methodologies, inputs and analysis and communicates its methods, findings and guidance to stakeholders. TAAC uses different approaches in its development of Strategic Allocation and Tactical Allocation that are designed to add value for financial professionals and their clients. TAAC meets regularly to assess market conditions and conducts deep dive analyses on specific asset classes which are delivered via the Asset Allocation Summary document. Please contact your Touchstone representative or call 800.638.8194 for more information.

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