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Economic Update

Taken together, recent high-frequency indicators and private-sector data releases, along with survey information from businesses, households and financial markets, suggest that economic conditions during the period in which many key federal statistical publications have been delayed, the US economy has remained solid, expanding at a modest pace. That said, indicators we monitor also point to the heightened risks of slowing economic growth and to a downshift in momentum relative to earlier in the year.

Indicators Consistent with Expansion

Several measures indicate that underlying economic activity has remained positive in recent months. Most important, the services sector of the economy, which accounts for 70% of GDP, shows signs of continued strength. The October reading of the ISM Non-Manufacturing index increased to 52.4, an eight-month high, exceeding the most optimistic forecasts, signaling expansion. The pick-up in the headline index was driven by a large jump in the new orders index, where growth accelerated at the fastest pace in a year. Meanwhile the business activity index rose to 54.3 in October. (Recall that readings of the ISM indices above 50 signal expansion while readings below 50 portend contraction). Survey comments indicate a fractured growth picture, as some respondents indicated concern about the impacts of the federal government shutdown and new tariffs, while others indicate business as usual.

Conditions in the labor market continue to be characterized by low levels of job separation. Initial jobless claims for unemployment insurance benefits reported weekly, have remained near historically low ranges, with little week-to-week variation. The stability of claims suggests that despite several widely publicized reductions in force at S&P500 companies totaling over 100,000 (e.g., Amazon, Target, Verizon and Intel) firms have continued to retain workers and that layoffs remain limited, consistent with ongoing, though slower employment growth. Business sentiment in some sectors also reflects continued, if cautious, expansion. Temporary help usage, anecdotal hiring commentary, and regional Federal Reserve Bank surveys suggest that while labor demand has moderated, many firms continue to hire

selectively to meet steady, if not robust, levels of activity. Wage growth has eased from earlier highs but remains above pre-pandemic norms, supporting household incomes, underpinning consumer spending.

Consumer outlays, which account for a pivotal 70% of GDP, have also demonstrated resilience. Although sentiment measures have fallen to multi-year lows, household spending patterns reported by high-frequency card-transaction data compiled by Bank of America, and industry trackers indicate that middle-and upper-income consumers, supported by real wage gains, and softening inflation, continue to maintain steady outlays on essential services and nondurable goods. Nevertheless, there is growing evidence that lower-wage earners have trimmed spending in recent months, driven by a combination of inflated prices for food and services, higher borrowing costs, and concerns about benefits and income-risk due to the government shutdown. Surveys show that a large share of consumers, particularly hourly/gig workers, feel their wages are not keeping up with rising costs. Nearly 60% of consumers say their wage gains lag the pace of inflation and more than 25% have cut back on discretionary spending. A Reuters report noted that among lower-income earners and younger workers, inflation-adjusted income growth had slipped from about 3% annually to 2%, near the post-2008 crisis pace, meaning they have less discretionary income to spend.

While there is evidence that lower-income earners are paring back spending, or at least shifting more outlays toward necessities under the combined pressure of inflation, higher borrowing costs and increased economic benefits uncertainty, the bottom 40% of earners are estimated to account for just 22% of consumer outlays, implying the economy can continue to expand, albeit at a moderate rate, should current spending patterns persist.

In the business sector, several indicators point to continued investment momentum. High-frequency readings of core capital-goods shipments, private investment commentary, and recent quarterly reports to shareholders, have shown sizable increases, especially in areas tied to digital infrastructure, software, and the replacement of aging equipment. While overall industrial activity remains in contraction, according to the October ISM manufacturing index reading, which slipped further to 48.7, pockets of investment strength suggest firms are continuing to fund projects that support productivity and operational efficiency.

Financial conditions, while measurably tighter than earlier this year, remain supportive of ongoing economic growth. Credit spreads have widened modestly, and bank funding markets have shown no signs of material stress. These developments point toward continued economic resilience, even amid restrictive real interest rates, elevated equity prices, erratic trade and fiscal policies, and heightened geopolitical uncertainty.

The latest reading of our firm's proprietary [Economic Model](#), designed to signal a change in the direction of the US economy six to nine months ahead of an inflection point, remains above-trend pointing to expansion ahead.

Indicators Pointing to a Slowdown

While several high-frequency indicators point to lingering strength, a growing set of measures underscores the increasing probability that the economy is likely to remain in a period of moderate, below-trend growth for a while. These indicators span overall manufacturing activity, consumer psychology, forward looking sentiment metrics and certain labor market dynamics. The most notable evidence is seen in the manufacturing sector, which accounts for 15% of GDP. The ISM Manufacturing Index has remained below 50 for eight months, signaling contraction in factory activity. This pattern is consistent with reports of slowing new orders, elevated inventories reported by some firms, and a general pullback in demand for durable goods.

Household sentiment indicators have also softened. The University of Michigan Consumer Sentiment Index has declined in recent readings to its lowest level since June 2022 during the COVID era, amid growing concerns about the economic outlook, employment prospects, and household financial conditions. While deteriorating sentiment does not always translate directly into spending reductions, sustained declines in confidence typically precede slower consumption growth and increased precautionary savings.

Some forward-looking indicators, including composite indices that incorporate weekly and monthly data such as leading economic indexes and real-time business conditions models, have shown signs of deterioration. The decline in these metrics suggests that the balance of risks has shifted toward slower near-term growth, with several components, including new orders, credit conditions, equity market volatility, and consumer expectations, contributing negatively. Business investment remains steady. However, several forward-looking indicators, including manufacturing surveys, consumer sentiment and consumer expectations foreshadow weakness.

Labor market data, though still reflecting resilience, also point to emerging signs of cooling. Continuing claims for state unemployment insurance have trended gradually higher in recent months, indicating out-of-work employees are taking longer to find new employment. Firms in select sectors report reduced hiring plans, and some regional surveys report more modest hiring and rising applicant pool availability. These developments, while not indicative of a sharp downturn, suggest softening labor demand.

Additionally, housing, as well as other interest rate sensitive sectors, remain a significant drag. Elevated mortgage rates and persistent affordability concerns have weighed on home sales, single family construction, and housing-related durable goods purchases.

On balance, high frequency indicators available during the government shutdown depict an economy that remains on a solid, modest expansionary path but shows signs of decelerating momentum. The labor market, which continues to provide support to households and consumer spending, has not exhibited the abrupt weakening that has historically preceded a sharp slowdown in overall economic activity. Business investment remains steady in several key subcomponents. However, several forward-looking indicators including manufacturing surveys, consumer sentiment and select labor-market indicators suggest the pace of growth has slowed in recent months and that downside risks have increased.

The Fed

The outlook for short-term interest rates administered by the Fed has become increasingly murky due to the growing split within the central bank over whether persistent inflation or a sluggish labor market poses a greater threat to the economy. The divide stems from the unusual state of the economy where simultaneous upward pressure on inflation and near-stagnant job growth threatens stagflation. The split within the Fed has been exacerbated by the government shutdown where officials have been temporarily denied monthly employment and inflation reports which might help them reconcile their disagreements. The data void allowed officials to turn to private surveys or anecdotes that reinforce earlier assessments. Doves are worried about labor market softness but lack evidence that would support a strong case for cutting. Hawks, who have seized the opportunity to argue for a pause, point to steady consumer spending and their concern businesses are preparing to pass along tariff-related price increases. Whether the FOMC cuts rates at its December 9-10 meeting is a toss-up. Financial futures show the odds of a December rate cut as 50/50. New data could settle the debate. Some Fed officials view the December and January meetings as largely interchangeable, making the yearend deadline less important. Another possibility would pair a December cut with guidance that sets a higher bar for future rate reductions. New inflation and jobs data expected prior to the Fed's next meeting may help resolve some of these issues.

Inflation

The most recent official data available shows the annual change in the Personal Consumption Expenditures Price Index (PCE), the Fed's preferred inflation gauge, stood at 2.7% for the twelve months ended August. The annual "core PCE," excluding food and energy, was 2.9% for the same period. The Consumer Price Index, (CPI) rose 3.0% year-on-

year in September 2025. On a monthly basis, the CPI increased 0.3% in September. Both measures have stabilized but remain well above the Fed's 2.0% target. This stabilization, in our view, provides room for the Fed to consider lowering its reference rate next month.

The Outlook

Balancing the above factors, we conclude the overall economy is sound, well financed, growing moderately, at or below 2.0% trend. The near-term risks are tilted toward slower growth over the next one to two quarters. Further interest rate cuts, moving the currently restrictive Fed Funds rate toward the so-called neutral rate which we assume to be 3.5%, are likely in 2026, though the timing of additional accommodation is uncertain given the current tug-of-war at the Fed. Interest rate sensitive sectors of the economy, which have been in their own recession, are likely to benefit from eventual further easing, as will small companies which lack direct access to the public debt market for financing. Strong household balance sheets and favorable labor market conditions argue for continued consumption growth as sentiment improves following the reopening of government.

Beyond the next quarter, as 2026 progresses, we expect to see a significant broadening and strengthening in economic growth driven by the tax cuts and supply side incentives written into law as part of the One Big Beautiful Bill Act (OBBBA). The OBBBA makes permanent the lower tax rates enacted in 2017's Tax Cut and Jobs Act, eliminates taxes on tips and overtime, increases the standard deduction for single and married filers, introduces deductions for seniors and those who pay interest on car loans, and raises the cap on the SALT deduction for those paying state and local taxes. Equally important, will be benefits to the economy from the supply side impacts of OBBBA which include increases in the small business tax deduction, increases the thresholds and makes permanent the Qualified Business Income Deduction, and allows for 100% immediate expensing of new investments in factories and production facilities.

In short, the US economy will benefit from a favorable policy mix of stimulative fiscal policies, further Fed easing and regulatory relief. Tax cuts are likely to boost consumer spending and the incentives for increases in capital investment should provide the basis for long-term economic growth, just as the US celebrates its semi-quincentennial.

Equity Investment Policy

While cap-weighted US stock market valuations are lofty following almost three years of double-digit advances, ample liquidity, declining interest rates, operating leverage, supportive and pro-cyclical fiscal policies, a growing economy where revenues and earnings next year are widely forecast to show double digit advances, and an administration which grades itself

on a rising stock market, is favorable for risk assets, providing a bullish backdrop for equity investors. We believe we are in the early innings of a new, highly innovative economic cycle fueled by AI and robotics-driven productivity gains. Near-term, softening labor market conditions, stable inflation, and falling energy prices will provide cover for further Fed easing, though the timing of future rate cuts is uncertain.

We expect the broadening stock market leadership reflected in the performance of well-diversified portfolios such as those we manage to continue. Equity portfolios under our firm’s supervision remain fully invested within their established guidelines.

Nevertheless, markets have become highly concentrated, which implies an elevated degree of short-term risk for portfolios with large concentrations in mega-cap technology and telecommunications services stocks, should sentiment toward that group turn negative. We last saw a similarly high degree of concentration at the peak of the 2000 tech bubble when technology stocks accounted for 33% of the S&P500. Today, the top 10 mega cap AI related S&P500 technology and telecommunications services stocks account for over 40% of that cap-weighted index. High-flying Nvidia alone represents 8% of the S&P500. Combined, Microsoft, Apple and Amazon account for 16% of the index. So, just four mega-cap technology stocks account for nearly a quarter of the S&P500’s market cap. Of concern are the currently high valuations of technology and telecommunication services stocks in general. Accordingly, portfolios we manage are intentionally underweight to this group and other speculative tech and telecommunications shares.

These high valuations raise the question of whether stocks in general are being driven by an unsustainable wave of speculation that will end badly. Several market-based indicators commonly used to detect speculative excess are elevated. When aggregated, these indicators show materially higher speculative activity than during ordinary market expansions. The strongest signals are record nominal margin debt, record options contract volume, and unusually high returns from unprofitable/ no-earnings stocks versus profitable cohorts, all accompanied by sustained, large retail share-of-market activity. These metrics are not definitive proof that a market downturn will follow, but they do represent hallmarks of prior speculative episodes. Caution is advised: “trees don’t grow to the sky” and sentiment-driven corrections are inevitable. Given the rich valuation of the stock market, 23X S&P500 earnings, we believe equities are vulnerable to a 10%+ pullback. High flying speculative tech shares are likely to experience greater drawdowns. However, a correction would not diminish the longer-term attractiveness of risk assets.

Portfolios under Front Barnett management are well diversified between large cap *growth* and *value* shares. Domestic small cap equities and international developed and emerging market shares are also components of our investment platform. Recall that by blending core

growth and *value* equities in a single portfolio, a style unique to Front Barnett management, we seek to smooth portfolio returns over a market cycle.

Fixed Income Investment Policy

Target fixed income portfolio durations remain unchanged at a conservative 2.75 years. Diversified, highly marketable, corporate bond portfolios are laddered out to 5 years. Short-term rates have drifted lower as expectations of further Fed rate cuts have been priced in. Longer-term rates have remained within range as fears of future inflation and negative sentiment regarding US fiscal policies cloud the outlook for the US dollar. We see longer-term rates range bound over the intermediate term. We view bonds as providing income producing ballast in times of stock market turbulence, a key component of a conservative, balanced investment program.

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Indexes are unmanaged, do not include fees or expenses and are not available for direct investment. Definitions: **Personal Consumption Expenditures Index (PCE)**: A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. **Conference Board's Confidence Index**: The Consumer Confidence Survey® reflects prevailing business conditions and likely developments for the months ahead. **ISM Manufacturing Index**: The ISM manufacturing index or purchasing managers' index is considered a key indicator of the state of the US economy. It indicates the level of demand for products by measuring the amount of ordering activity at the nation's factories. **ISM Non-Manufacturing Index**: The Institute of Supply Management (ISM) Non-Manufacturing Index is an economic index based on surveys of more than 400 non-manufacturing (or services) firms' purchasing and supply executives. **S&P 500 Index**: The S&P 500 Index, or Standard & Poor's 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the US. **S&P 500 Growth Index**: The S&P 500 Growth Index is a stock index administered by Standard & Poor's-Dow Jones Indices. As its name suggests, the purpose of the index is to serve as a proxy for growth companies included in the S&P 500. **S&P 500 Value Index**: The S&P 500 Pure Value Index refers to a score-weighted index developed by Standard and Poor's (S&P). The index uses what it calls a "style-attractiveness-weighting scheme" and only consists of stocks within the S&P 500 Index that exhibit strong value characteristics.

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