



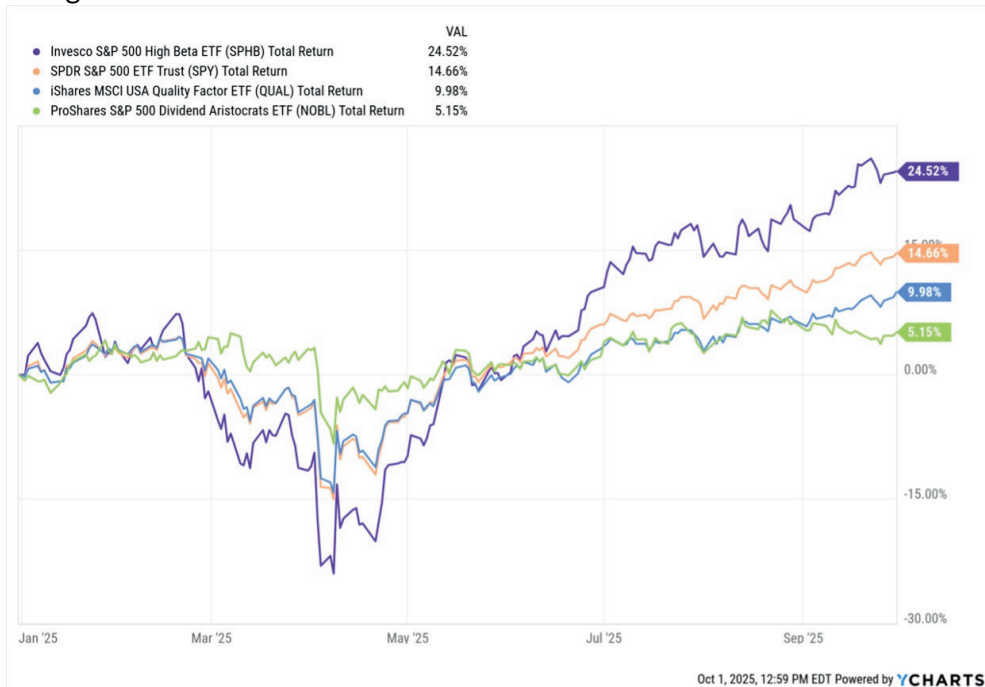
Early or Late Cycle?

The economy tends to move cyclically. Recessions give way to growth, which eventually overheats, causing rising inflation. Interest rates rise, which slows growth and triggers a recession, restarting the cycle. Currently, economic and stock market data are sending conflicting signals: economic indicators suggest we are late in the cycle, while market performance and the types of stocks leading gains imply we are early in a new economic growth phase. Eventually these signals will realign, but let's take a deeper look at what both are currently saying.

The Stock Market

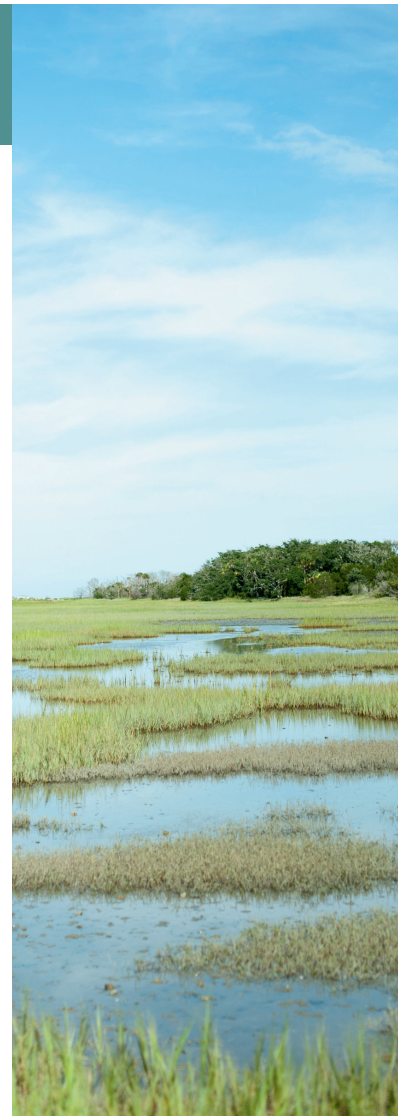
Stocks are indicating that corporations and the economy are in a good position. All the major indices we follow are within about 5% of their all-time high, and most are within 2%. The S&P 500 is up 18.7% over the past year, and 14.8% year-to-date. There is strength at the broad index level, but the gains are being led by lower-quality, more volatile areas of the market that tend to do better when the economy is coming out of a sharp contraction- indicating the market believes we are early cycle.

The chart below shows the performance of several index funds with different stock styles. SPHB represents the most volatile large stocks; SPY is the "plain vanilla" S&P 500; QUAL tracks the highest quality large stocks; and NOBL is the dividend aristocrats- very high quality, established companies with a long history of rising dividends.



As you can see, more volatile, lower-quality stocks have outperformed this year. Likewise, higher dividend payers (more stable companies) have underperformed lower dividend payers. Cyclical sectors, such as industrials, technology, and financials, are all outperforming their defensive counterparts like healthcare and consumer staples.

Continued on page 2



INSIDE THIS ISSUE

Early or Late Cycle?	1-3
OBBBA: Trump Accounts	4

SPECIAL POINTS OF INTEREST

- If you would like to schedule a meeting for planning or portfolio questions, don't hesitate to contact us!
- Q4 Market & Office Closures:
 - Thanksgiving- Nov. 27th-28th, 2025
 - Christmas - Dec. 24th-26th, 2025



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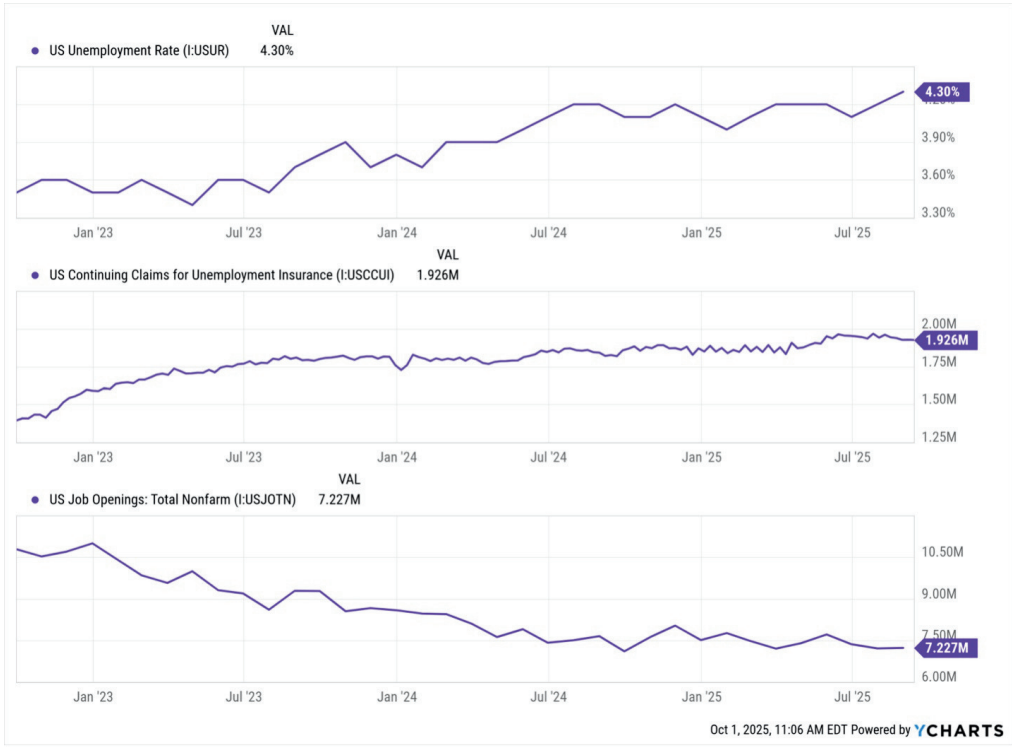
These are all signals that the stock market believes we are nowhere near the recessionary part of the economic cycle.

This dynamic of low-quality outperforming high-quality is observable in stocks of all sizes. We look at the performance of Russell indices compared to S&P indices to assess this in mid and small size stocks. S&P indices have a screen for profitable companies, whereas Russell indices do not. As you can see, the Russell indices, which contain lower-quality stocks on average, are handily outperforming the higher-quality S&P indices.

	Russell (Lower Quality) Total Return	S&P (Higher Quality) Total Return
Mid Cap	10.2%	5.7%
Small Cap	10.4%	4.2%

Economic Data

While the economic data is not suggesting we're on the cusp of recession, it is indicative of a much more late-cycle environment, and it has been deteriorating over the past year. This can be very clearly seen in the labor market. The unemployment rate is rising, as are continuing claims for unemployment insurance. It's no surprise that we're seeing this- job openings have been falling steadily.



Inflation, an indicator of an overheating economy, has been a persistent problem for some time now, and there's little indication that we've fully put this issue behind us. Three out of four inflation measures we follow are up year-on-year, and all four seem to have inflected higher around May of this year. Furthermore, market-based measures of future inflation expectations have been rising. This is classic late-cycle data.

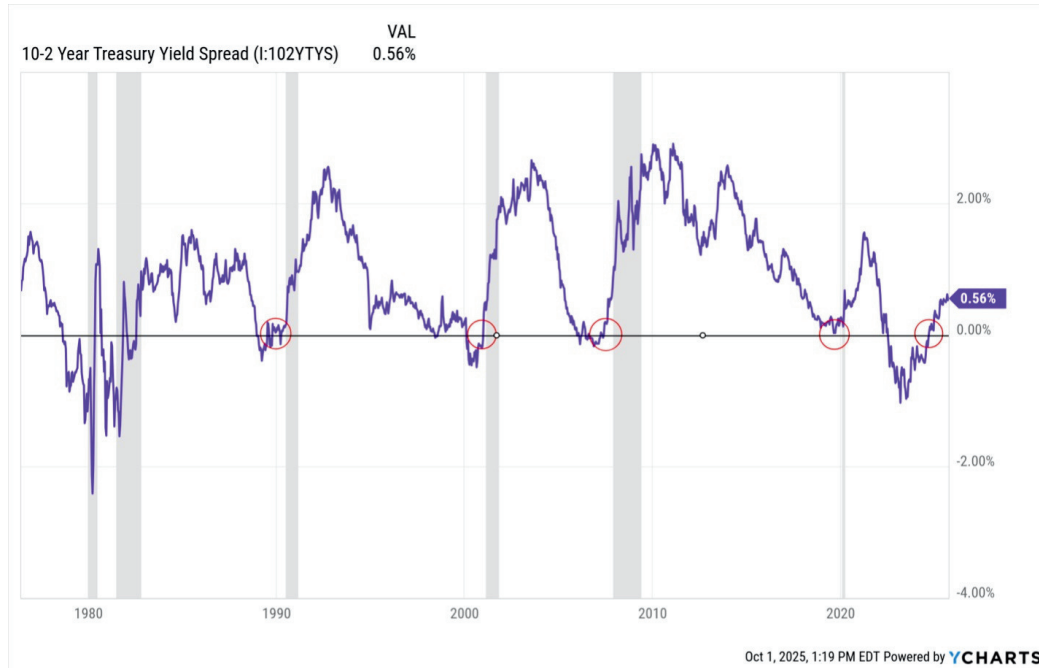
The Bond Market

The bond market is also sending conflicting signals. On one hand, it is confirming that conditions for corporations are good- spreads between bonds issued by low-quality companies and treasuries are near all-time lows. This indicates a healthy environment for corporations. These spreads typically widen significantly before recessions, and we are not observing that now.

Continued on page 3

Early or Late Cycle?

On the other hand, the treasury yield curve has uninverted and steepened. This typically happens shortly before recessions- indicating we are late cycle. The chart below shows the 10-year / 2-year treasury yield spread. As you can see, prior to the past four recessions (shaded), this spread went negative, flipped back to positive, then moved further into positive territory.



The curve un-inverted about a year ago and has continued to steepen since then- without a recession yet. This has historically been a very reliable indicator of a late cycle economy, so we take this seriously when we see it.

Looking Ahead

When we see a divergence between economic data and the markets, we typically defer to the markets because they are forward looking, whereas the data is backward looking. However, markets can be prone to bouts of overenthusiasm, and it's possible that this divergence between market and economic data is being driven by market enthusiasm for the AI buildout, which is masking underlying economic weakness.

There are a few small areas of the market that are giving the same message- oil prices are down over 11% year-to-date, materials stocks and homebuilders are down more than 5% and 10% respectively over the past year, and the S&P transportation index is negative year-to-date.

In light of this, we are focused on remaining invested in higher quality stocks and bonds despite their underperformance year-to-date. Higher quality assets tend to hold up much better during market corrections and in recessions and have historically outperformed their low-quality peers. For the same reasons, we feel it's prudent to remain invested in the dividend paying stocks we own. We have been rebalancing client portfolios as necessary and paring back positions that have grown to be too large. We feel that portfolios are well positioned for whatever comes next.

Index	Q3 Total Return	YTD Total Return	1 Year Total Return
S&P 500	8.2%	14.8%	18.7%
DJIA	4.7%	10.5%	12.0%
Nasdaq Comp	12.3%	17.9%	27.4%
MSCI EAFE	4.8%	26.5%	16.6%
Russell 2000	11.2%	10.4%	12.4%
US Aggregate Bond	2.2%	6.2%	2.6%



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OBBBA: Trump Accounts

One of the most common non-retirement-related questions clients ask is how to save money for their kids or grandkids. There are a few options, and the One Big Beautiful Bill Act (OBBBA) just added one more with the introduction of "Trump Accounts." President Trump discussed the idea of saving and investing for children during his campaign, so seeing this idea resurface in OBBBA in July wasn't a surprise.

The most exciting part of the Trump Accounts is that kids born between 2025 and 2028 can receive a one-time contribution of \$1,000 from the federal government. The mechanics of how this will work are unclear, but for anyone who has a baby born in those 4 years, it's a good opportunity to get some free cash invested early!

The easiest way to think about Trump Accounts is to compare them to Traditional IRAs, but there are a few differences. These accounts can be opened for anyone with a Social Security number from birth until the year they turn 17. Starting in July 2026, up to \$5,000 a year can be contributed per beneficiary. Entities other than people will be able to contribute to these accounts, including government, charitable organizations, and employers. Employer contributions count toward the \$5,000 cap, but government and charitable organization contributions do not.

There are a few differences between Trump Accounts and IRAs. The first is that there is no earned income requirement for contributions to Trump Accounts. This is a win, as young children usually don't have earned income since most kids don't start working until their teenage years. A second difference is that there is no income deduction for contributions made by parents or grandparents to these accounts.

Once the accounts are funded, the next step is to invest the contributions. The investment choices will likely be even more limited than most 529s or 401(k)s, as the funds can only track a qualified index primarily comprised of U.S. equities. However, there is some great news here: the annual fund fees can't be more than 0.1%. This is significantly cheaper than what is often found in funds offered through 401(k) plans, but many 529 plans offer investment options that are also inexpensive and offer more diversified investment options.

After an account is invested and growing, how do you utilize the funds and for what purposes? No distributions can be made until the year the beneficiary turns 18, apart from a few exceptions, including rollovers to other Trump accounts. Beginning in the year the child turns 18, the funds in the account can be invested any way the account owner would like, more like an IRA. It is currently unclear whether Trump accounts can be rolled into a Traditional IRA or converted to a Roth IRA.

Essentially, at age 18 the Trump account becomes an IRA and is intended for retirement, with most penalty-free distributions not permitted until age 59.5. There are some exceptions for IRA withdrawals before age 59.5 that avoid the 10% penalty, and these should also apply to Trump accounts. After age 59.5, contributions can be withdrawn tax-free, but the investment growth is taxed at ordinary income rates.

If your savings goal for a child is for education, the 529 is still the best option. Tax-free growth and the ability to roll \$35,000 from a 529 plan to a Roth IRA help reduce the risk of overfunding, and the investment options will also be more diversified. Suppose your goal is to save for non-education-related expenses. In that case, there is still likely a better option than Trump accounts that will allow for more flexibility and potentially result in a lower tax bill as well.

Aside from the free \$1,000 and any employer contribution opportunities, I'm unsure if Trump accounts will work for most families. There are more flexible and simpler options that can achieve the same goals. However, if this is something you want to explore, these accounts will be available starting in July 2026.



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