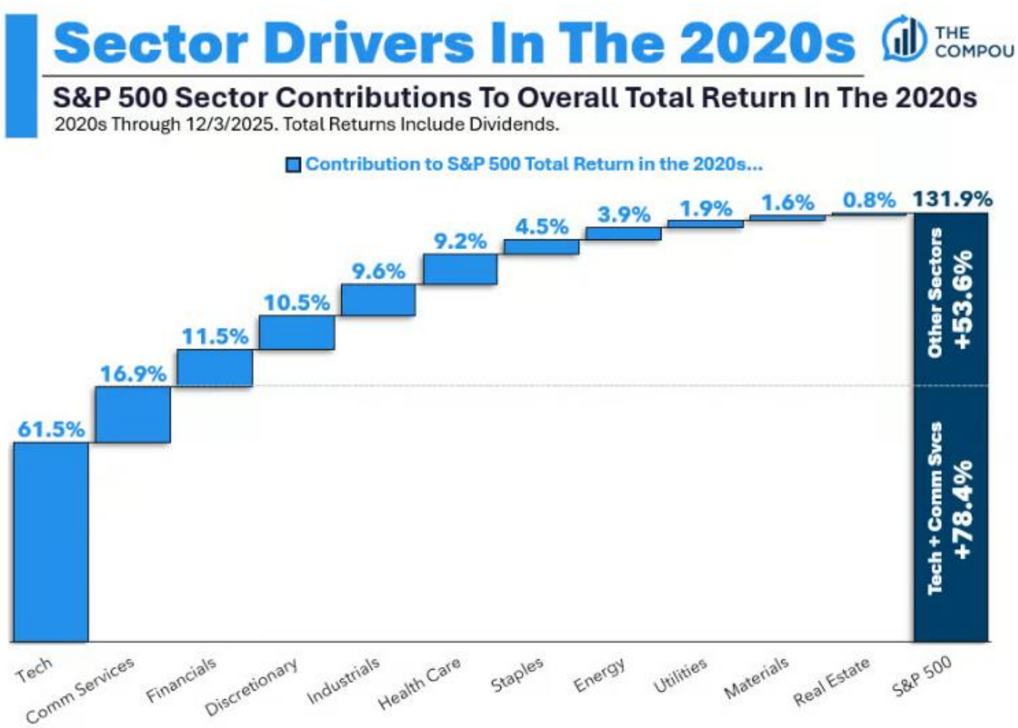
Stocks finished slightly higher last week – the S&P 500 was up 0.3% compared to last Friday's close. Following the end of the government shutdown in mid-November, we're finally getting a fresh look at data showing the health of the U.S. economy. Overall, things seem to be holding up fairly well. September's delayed release regarding consumer income and spending (released last Friday) levels showed healthy monthly increases of 0.4% and 0.3%, respectively, for example. Core PCE inflation through September came in at 0.2% month over month and 2.8% year over year, slightly above the Fed's 2% target but not unreasonably high. In short, the economic expansion appears well enact, supported by a resilient consumer and robust capital investment. The updated GDP forecast for the third quarter (provided by the Atlanta Fed's GDPNow forecasting model) sits at 3.5% while it's widely expected that the Fed will cut rates another quarter point at this week's meeting.

With an accommodative economic backdrop, high levels of capital spending, and a Fed that's cutting rates, this is an ideal environment for stock investors. Earnings forecasts into next year keep getting revised higher, and it's my view that near-term estimates may be too modest given the massive beats we saw for the third quarter. All of this bodes well for the health of this secular bull market. Furthermore, profit margins have been expanding, which reflects both economics of scale for some of the largest growth companies as well as broader productivity gains. S&P 500 earnings are expected to grow by 17% in 2026 following 13% growth this year.

The driver fueling this bull market has been clear – massive capital spending funded through the free cash flow produced by the largest technology behemoths. So far this decade, technology stocks have accounted for nearly half of the market's gains.

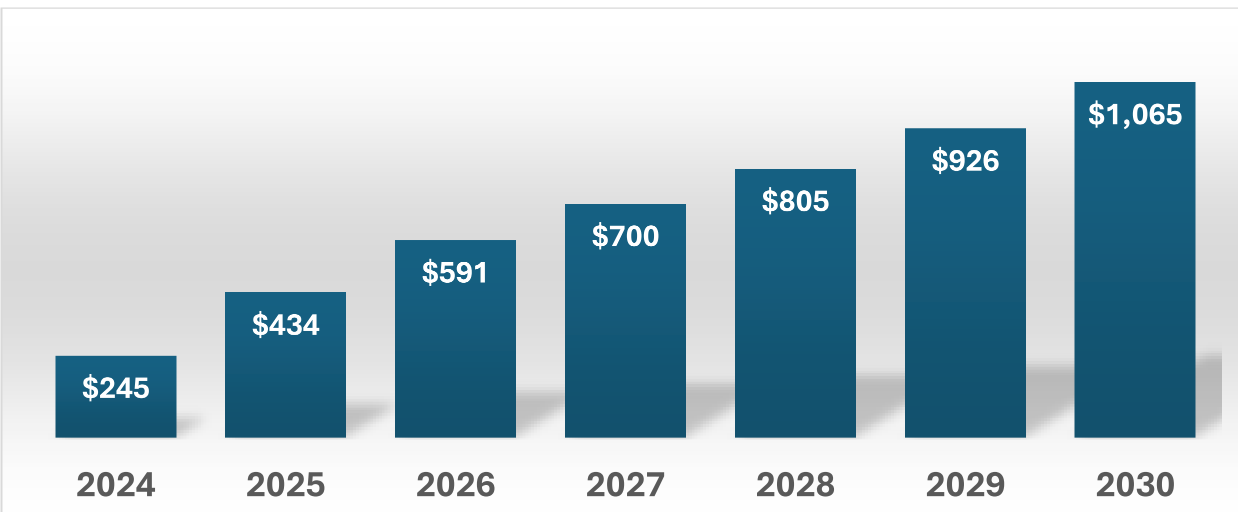


Source: Bloomberg, A Wealth of Common Sense, Chartkidmatt.com

As massive capital investment in AI continues, earnings growth and productivity gains are now broadening beyond the leading technology names. When excluding the largest seven technology companies (which account for a combined 35% of the S&P 500), for example, S&P 500 earnings are still expected to grow roughly 12% next year, well above the historical average of 7-8%. This indicates that the hundreds of billions annually deployed on AI infrastructure are lifting prospects not only for companies directly inside the ecosystem, but also for a wide range of adjacent sectors.

I strongly believe the trajectory and magnitude of AI-related capital spending is the most important factor driving returns going forward, not just for large-cap technology companies but for the broader market and the economy as a whole. Current estimates suggest AI capital investment may reach over $1 trillion annually by the end of the decade, which would account for roughly 3% of U.S. GDP. At nearly half that amount currently, this is already lifting economic growth by roughly 1.5% annually according to my estimates. In essence, the 3.5% current forecast for GDP growth would likely be closer to 2% if not for the AI infrastructure buildout.

<u>Annual AI Capex ($B) Forecast For AI Hyperscalers</u>



Source: Morgan Stanley, Dell'Oro Group, and Cube Research

As these capital investments season, I believe the wide-reaching economic benefits will further broaden. This suggests further upside for profit margins and corporate earnings. As we receive additional guidance and commentary from leading companies going forward, I expect more beats and upside surprises like we saw during the third quarter earnings season. It's my view that this is a long-term secular tailwind that should continue to propel the market years into the future. In fact, many companies are now providing multi-year guidance showing robust growth and a clear path to achieving those milestones. While valuation levels across the market are somewhat elevated compared to history on the surface, I believe they are more than justified given the growth outlook.

Andrew P, Kerai, CFA®, Chairman & Managing Partner

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